AUSTRALIAN BANKERS' ASSOCIATION INC.

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Mr Maurice L Newman AC
Chairman
Financial Sector Advisory Council
c/- Financial System Division
Department of the Treasury
Langton Crescent
PARKES ACT 2600

Dear Mr Newman,

FINANCIAL SECTOR REGULATION

Thank you for letter of 26 September 2005 inviting the Australian Bankers' Association ('ABA') to make a submission to the Financial Sector Advisory Council ('FSAC') on identifying efficiency gains that can be made through practical improvements to the operation of financial sector regulation. The ABA notes that it has also recently submitted to FSAC regarding improving the regulatory framework to facilitate the adoption and use of technologies in the financial sector.

The ABA strongly supports FSAC's inquiry and the announcement in October by the Prime Minister and Treasurer of the Taskforce examining regulation. The ABA will also be submitting to the Government's Regulation Taskforce ('Banks Taskforce'[1]) and providing comments along similar lines as those contained in this submission.

1. Background

The ABA represents 26 Australian and overseas banks and has wide representative coverage of the banking as well as the broader financial services sector. Our governing body is the ABA Council comprising 12 bank chief

[1] http://www.regulationtaskforce.gov.au/index.html

executives. The Council has set as one of the ABA's key priorities an objective to "Ensure that regulation meets the principles of sound regulation." As a result most of the matters that are identified in this submission are already being addressed by the ABA.

With the ABA Council priority in mind the ABA, as part of its membership of the Finance Industry Council of Australia ('FICA')[2], commissioned an extensive review of regulation in the financial services sector by CRA International ('FICA Report') – *Enclosure 2*.[3] The ABA commends the FICA Report for its excellent analysis and representation of the impact of regulation on the financial services sector though we do not support all its recommendations.

The ABA will also prepare and send later this year a separate document on payments system reform, for the consideration by FSAC. We have prepared a separate report because of the relatively discrete nature of the payments system issues and believe that the content is of direct relevance to FSAC's inquiries.

FSAC will be aware that banks (and other Approved Deposit-Taking Institutions {'ADIs'}) and the card schemes have been subjected to a number of waves of significant payments system changes both actual and proposed. This has occurred through regulation, and follows the publication of the Reserve Bank of Australia ('RBA') and the Australian Competition and Consumer Commission's ('ACCC') joint study in October 2000 of interchange arrangements for credit cards, EFTPOS, Visa debit card and ATMs.[4] The catalyst for this study was the Wallis report.[5] The ABA believes that five years on, it is time to review the impact of the regulation of the payments system.

The ABA provides, on behalf of our member banks, to FSAC for its consideration, some general observations and specific comments on the particular questions posed to the ABA about financial services regulation.

2. General observations: The ABA's overall view on regulation

The ABA believes that effective regulation is important. It leads to confidence in our markets and protects consumers.

The ABA also agrees with the views laid down in the Wallis Report. The Wallis Report provided that the three primary purposes of regulation are to:

- Ensure that markets work efficiently and competitively;

2 FICA comprises: Australian Bankers' Association, Australian Finance Conference ('AFC'), Australian Financial Market Association ('AFMA'), Investment and Financial Services Association ('IFSA') & Insurance Council of Australia ('ICA'). International Banks & Securities Association of Australia ('IBSA') joined the FICA group for the purposes of commissioning the Report.

3 "Review of Business Regulation in Australia", CRA International, November 2005.

4 "Debit and Credit Card Schemes in Australia – A study of Interchange Fees and Access", Reserve Bank of Australia & Australian Competition and Consumer Commission, October 2000.

5 Report of the Financial System Inquiry, March 1997.

- Prescribe particular standards or qualities of service; and
- Achieve social objectives.

The Wallis Report set down five key principles of regulation that should be observed to achieve these primary purposes:

- Competitive neutrality;
- Cost effectiveness;
- Transparency;
- Flexibility; and
- Accountability.

It is the ABA's view that nothing has fundamentally altered since the Wallis Inquiry (despite the recent cases of corporate malfeasance such as HIH and One.Tel) to undermine the importance and desirability of principles-based legislation and financial services regulation as advocated by the Wallis Inquiry.

The ABA also understands and accepts that banks hold a unique position in the market both by virtue of the size of the sector and the special function banks perform within the economy. This necessarily impacts on the regulation of the banking sector.

The ABA believes that "good regulation" requires coordination and cooperation between legislators, government, regulators and industry. In this context it is important to get the balance right between the cost and benefit of regulation; clarity/certainty and flexibility of regulation; and between consultation in drafting and implementing regulation and enforcement. If the balance is wrong it can lead to costly and less customer-friendly outcomes for consumers. The Financial Services Reform Act ('FSRA') process is an example of how an unbalanced approach can lead to a costly regime that has many unfriendly outcomes for consumers.

There are many challenges for all the participants in the regulatory process. The challenge for banks in implementing good regulation is understanding the myriad of obligations (which at times may overlap between regimes or are inconsistent across regimes, not just domestically but internationally), e.g. some of the Australian Prudential Regulation Authority's ('APRA') proposals in its draft *Fit and Proper and Governance Standards*. Whilst APRA has acknowledged the industry's concerns, banks will still have to undergo an exhaustive process to meet the standards in APRA's draft.

The challenge for legislators and governments in introducing good regulation is to balance the public interest with the realities of compliance burden for banks that are inevitably passed to customers, either in whole or in part, thereby increasing the cost of banking, e.g. FSRA.

The challenge for regulators in administering regulation is balancing the need to be consultative with industry (in order to develop soundly based policy) and the reality of their enforcement role.

It is also worth mentioning the growing impact of international regulation which has been significant for banks. To a degree, the high level of regulatory change in place or underway reflects Australia's commitment to implementing consistent business regulatory rules to those internationally. The key examples that come to mind are: Sarbanes-Oxley ('SOX'), international financial reporting standards ('IFRS'), Basel II, the Financial Action Task Force ('FATF') *Forty Recommendation*s into anti-money laundering legislation ('AML'), the flow-on effects of the U.S.A. Patriot Act, and the recently proposed outsourcing policy by the Reserve Bank of New Zealand.

Acknowledging these observations above, it is the ABA's view that the regulatory burden faced by banks has increased markedly in recent years. This has lead to a substantial rise in compliance costs and affected the way financial products are offered to customers. Has it all been bad? No, we don't think so.

The FSRA regime provides a legal basis for the Australian Securities and Investments Commission ('ASIC') to ensure that standards for financial services providers across the industry are of an appropriate and professional level. Similarly, APRA administers that law so that consumers can have confidence in a robust banking system. However, the dominant view of our members is that the balance between the costs and the benefits has not been favourable for banks, and most importantly for bank customers.

Therefore, the purpose of the ABA response to FSAC's inquiry is to highlight how addressing unnecessary complexity and uncertainty can reduce compliance costs for banks and other financial institutions.

3. Specific comments

3.1 Regulatory challenges

In summary, and in thematic form, we believe that there are a number of significant factors that have contributed to the challenging regulatory regime for banking and financial services:

- Incrementalism and "reform fatigue";
- Increased prescription versus principles-based guidance;
- Consultation and transparency when implementing regulation;
- Cooperation between regulators;
- Lack of national uniformity; and
- Creation of a "compliance culture".

3.1.1 Incrementalism and "Reform Fatigue"

Over recent years there has been considerable legislative and regulatory change for corporations and financial services providers. ABA members report that each new piece of regulation, be it large or small, adds to the already considerable burden of regulation.

In some cases complex regulation leads to an increased compliance burden, which in turn creates higher financial sector levies (under recent changes to the methodology for calculating levies), which all adds to the cost base of banks. Appendix A of the FICA Report shows the increasing costs of funding regulators both in actual terms and as a proportion of total financial assets of financial institutions. The cumulative effect of a range of regulatory obligations and the interplay between regulatory requirements is of significant concern for our members.

The corollary of incrementalism is compliance or reform fatigue. In particular, corporate and financial services regulation has been substantial through the CLERP reforms, most recently being the CLERP 6 (FSRA) and CLERP 9 reforms. Procedural and systems changes have had a significant and ongoing impact on business. For example, every change made to the Product Disclosure Statement ('PDS') requirements results in substantial cost due to legal/advisory fees, technology scripts, staff resources and printing and distribution costs.

Significantly, there appears to be more in the pipeline despite the Government's post-election commitment to slow legislative and regulatory reform down. The Government's Corporations and Markets Advisory Committee ('CAMAC') and the Parliamentary Joint Committee on Corporations and Financial Services inquiries are looking at very complex and significant corporate law matters, including personal liability for corporate fault, corporate duties below board level, "long-tail" liabilities and corporate responsibility. All these matters are likely to have a substantial impact on the business of banking.

It is the ABA's view that governments, legislators and regulators need to be mindful of the impact of each additional piece of regulation, however small, as the cumulative effect of legislative and regulatory change can have much wider ramifications for the efficiency of our financial and capital markets.

3.1.2 Increased prescription vs principles-based guidance

In the spirit of principles-based legislation, the ABA believes that business regulation should be focused on guiding behaviour towards desired outcomes. Notwithstanding, regulatory policy and guidance should be able to be interpreted with reasonable levels of certainty as to their meaning and effect without requiring undue resources.

Many areas of core concern to business currently require very high resourcing to achieve reasonable levels of assurance as to legal and operational compliance. In part this is due to the fact that regulators in their administration of the law appear, at times, unwilling to rely on broad principles, but rather issue substantial and detailed policy and guidance. This approach means that the notion of principles-based is lost in the translation from regulatory formation to administration. While intended to aid certainty, it can often create the opposite effect when applied in practice.

It is acknowledged that some guidance is necessary, and that the objectives of simplicity and certainty are at times contradictory, but it is the ABA's view that the pendulum has swung too far, particularly when regulatory policy that has been developed as guidance or interpretation of the law, is used in a prescriptive manner as part of a surveillance campaign or an enforcement proceeding. The ABA recognises the need for regulators to enforce the law; however, there is a tension between the "spirit of the law" and the black letter of the law approach. This can often lead to legislators and regulators saying things that are at times inconsistent with surveillance and enforcement practice.

The ABA supports Recommendation 1 in the FICA Report, which encourages the Government to adopt light-handed or outcomes focused model of regulation following the policy framework articulated in the Wallis reforms.

3.1.3 Consultation and transparency when implementing regulation

On occasion, regulation is implemented with inadequate consultation and a lack of commercial pragmatism. A recent example is the Anti Terrorism Bill 2005 ('ATB') which has the potential to conflict with mooted provisions of the yet to be released Anti-Money Laundering Bill. The ABA had to determine its first response to the Bill on the basis of reading the unofficial version of the Bill on the ACT Government website and in an unrealistically short time frame. This has now been corrected, and the second ATB Bill is currently the subject of consultation with a Senate Committee.

There are also concerns about the level of experience and commercial pragmatism of some staff within Australian regulators, especially when compared to their peers overseas. For example, there were difficulties for banks in explaining to ASIC some of their financial services operations and arrangements during the FSRA licensing process and ABA members felt that they were more educating ASIC as to these matters, rather than making an application for a licence. To some degree the implementation of the FSRA regime can be acknowledged as a difficult time for both the regulator and industry because the FSRA requires the application of both the law and considerations of business efficacy to deliver the right outcome; however, some concerns remain with regulatory staff ability and insight into the business implications of a particular policy approach which may impact on the timeliness and quality of decisions on applications for relief.

The ABA acknowledges some of the challenges that regulators face in attracting and retaining staff and resources, and in particular we recognise ASIC's efforts in recently consulting with industry regarding its strategic plan and resource deployment. However, inefficiencies can have a significant impact as, for example, applications for relief can be time consuming and therefore costly, both for the regulator and industry. This is causing frustration and additional and unnecessary risk as post-FSRA implementation requirements; ongoing administration and management of regulatory compliance issues are compromised by the necessity to quickly address the latest new issue.

In addition, recently there have been instances where there have been ambiguous statements made by regulators in their administration of the legislation. For example, ASIC's recent surveillance campaign on ''super switching" contained statements regarding the need for some industry participants to give closer consideration to how they manage conflicts. However, in public statements, some ASIC staff has made comments regarding systemic concerns with industry practices in the superannuation industry and lack of trust in professional financial advisers. Unfortunately, ambiguous or inconsistent statements made by the regulator can be confusing for consumers, and industry, and can have unnecessary and adverse consequences for consumer confidence.

Having said that, we believe that overall the banking industry has a positive and cooperative relationship with our key government and regulatory stakeholders. In recent times we have noticed a better level of consultation from Government and regulators. For example, Treasury staff has made themselves available for the banking industry as part of the FSRA refinement process.

In addition, the ABA welcomes APRA's revamp of its prudential regulations, by replacing the current system of prudential guidance notes with what will be known as 'Prudential Practice Guides' ('PPG'). The initiative is welcome because the PPG's will give institutions more flexibility in meeting prudential standards, but still outline best-practice and provide a benchmark to which specific institutional arrangements can be assessed. APRA's recognition that an overly prescriptive approach to prudential regulation, as inherent in the guidance note system is a good step in reducing unnecessary business costs.

The ABA supports Recommendation 2 of the FICA Report about improving consultation. In addition to Recommendation 2, we also suggest that to enhance the commercial acumen and pragmatism of regulatory staff, that it may be worthwhile considering the following:

1. Introducing an "industry advisory panel" model to assist ASIC in its general policy formulation in much the same way as ASIC is assisted by its consumer advisory panel. An industry advisory panel could also provide a consulting mechanism for ASIC's Regulatory Policy Group ('RPG') in assessing and determining precedent applications for relief. The Panel could consist of a number of industry experts that could advise ASIC on the implications of a particular policy proposal and attend RPG meetings and provide industry input on particular RPG matters for consideration.

2. Introducing a regular information session program. The sessions would allow key industry participants to discuss with regulatory staff important emerging issues and assist in the development of more practical policy and standards.

3. Introducing a formal secondment program. The program could encourage greater interaction between regulatory staff and industry to assist in building a better understanding of, on the one hand, industry practice, and the other, government and regulatory process.

4. Reviewing the myriad of regulatory policy documents issued under the FSRA regime, including policy statements, guides, class orders and other relief instruments, FAQs, etc, with the view to developing a consolidated regulatory and policy reference framework that will facilitate simpler and more efficient decision-making by financial services providers and their advisers.

3.1.4 Cooperation between regulators

The banking and finance sector is arguably the most heavily regulated sector of the Australian economy, as it is affected by the activities of the RBA, APRA, Australian Transaction Reports and Analysis Centre ('AUSTRAC'), ASIC, ACCC, ATO and the Federal Privacy Commissioner. Many banks and financial institutions operate across more than one state and as a result are also subject to additional regulation imposed by State and Territory governments.

The ABA accepts the need for effective regulation of the financial services sector. However, there have been instances of overlapping and competing legislation and regulation. The clearest example is corporate governance which has attracted the intervention of ASIC, APRA and the ASX, and which we refer to in more detail below.

The ABA supports the principle (though not necessarily the specific solution) of Recommendation 10 made in the FICA report, which aims to reduce the incidence of duplication and inconsistency between regulators.

3.1.5 Lack of national uniformity

Banks are subject to a myriad of laws at the Commonwealth, State and Territory level. While it may be unreasonable to assume that there can be absolute consistency across corporate and financial services laws, the lack of consistency generates unnecessary complexity and compliance costs.

State to state overlaps and inconsistencies can significantly affect banks, e.g. States are beginning to develop laws in connection with workplace privacy and while NSW has recently legislated to regulate surveillance in the workplace, Victoria has recently released a different set of proposals to regulate workplace privacy.

It is the ABA's view that greater national harmonisation of regulation will reduce unnecessary, complexity, uncertainty and compliance costs. Therefore, the ABA encourages the nine Governments to reduce the incidence of a lack of uniformity in the regulation of banks and the financial services sector.

3.1.6 Creation of a "Compliance Culture"

The significant regulatory reform within the financial services and corporate sector over recent years has resulted in not just reform fatigue, but the creation of a "compliance culture". In particular, new or amended regulation has resulted in changes to the role and structure of the compliance function as well as wide ranging cultural impacts related to the everyday management of compliance as part of the business. The increase in legal and compliance staff within banks has created a focus for compliance consideration, input and direction in projects.

The ABA makes for the following observations:

- Directors' duties and responsibilities are now more onerous. Not only have liabilities increased as a result of corporate law reform but directors and officers now also face increased derived liabilities due to various other statutes, e.g. environmental protection, occupational health and safety, fair trading, etc. Personal derivative liability is a potential disincentive for qualified and competent individuals to take up senior positions in companies. Increased personal accountability is also driving up remuneration and adding wages pressure to senior positions.
- Training requirements for all staff in some particular areas, such as simple and well understood products, are unnecessarily onerous. Basic training is required for all customer-facing staff. In addition, organisations must have appropriate systems in place to monitor and record training. Policy Statement 146: Licensing: Training of financial product advisers [PS146] has had a number of adverse impacts on the industry, such as the emergence of the "no-advice" model.
- Customer's perceptions of a helpful culture supporting enquiries have changed to an over-regulated industry where "advice" and other enquiries are routinely directed to professional financial planners, or alternatively a "no-advice" model is adopted. Disclosure documents have been criticised for being too compliance driven and not providing the information sought by consumers.

The ABA also observes that since a number of recent high-profile cases of corporate malfeasance and the subsequent pressure on regulators, there has been additional pressure flowing through and placed on industry.

The ABA considers that there is a need to redress the apparent aversion to risk-taking by both the regulator and industry. Such an adjustment would allow greater application of the "spirit of the law". Flexibility will also enhance how principles-based legislation can be applied across the industry, regardless of the nature and complexity of the business. It would also ensure that legislative or regulatory changes are based on inherent deficiencies within the law, and not just reactionary to particular isolated cases.

3.2 Compliance costs

The FICA Report surveyed ABA members on their estimate of compliance and implementation costs and how this had changed over the past five to ten years.

It was reported that overall compliance costs had increased dramatically over the past five to ten years.

Ongoing compliance costs for the largest banks amounted to $30-40M per annum, representing 0.5% of operating income. These costs included compliance with various requirements including annual recurring costs for IFRS, Basel II and Sarbanes-Oxley Act ('SOX').

One bank reported that since 1994/95, compliance expenditure levels had almost doubled every five years, accompanied by growth in staff resources engaged in compliance-related activities.

Larger banks reported project costs associated with FSRA and APRA changes at between $30M and $40M per bank over the past two years. One major bank indicated that the majority of implementation costs related to Basel II ($60M) and IFRS ($20M). Another major bank estimates that it has spent significant costs on FSRA ($30M) and will spend $25M on AML. Another major bank indicates that in addition to ongoing compliance costs, it has engaged additional resources and costs implementing for Basel II ($25M) and FSRA ($5M). [6]

In 2003 the ABA sought estimates from its member banks on the direct costs of implementing FSRA. Costs included training, external advice, documentation, computer systems and procedures and grossed up to over $200M. Annual re-occurring costs were estimated at $50M. If the lost opportunity costs of staff having to be taken away from their productive work to implement the FSRA are added, the costs would be significantly higher. This is a cost not often taken into account when regulatory costs are being considered.

Similar to FSRA, the implementation of the Consumer Credit Code ('UCCC') from its enactment in 1994 saw one-off implementation compliance costs for banks of approximately $200M with ongoing annual recurring costs of approximately $50M.

The ABA believes that in formulating regulation there should be proportionality between the regulation and the consequences of non-compliance. The relationship between strict application of the law and the consequences of non-compliance with the law bears directly on the compliance costs and customer experience. It has been the case with the UCCC. There is a civil penalty regime where, if a key provision of the UCCC is breached by a credit provider, they face imposition of a civil penalty of up to $500,000.

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6 The ANZ Bank has been reported (Weekend Australian 5 Nov 05, p. 35) as estimating that "… it will spend $20 million on the introduction of international financial reporting standards, and a further $60 million on the Basel II project …".

There is a direct correlation between the UCCC's civil penalty regime and the undue length and complexity of some UCCC disclosure and other documents. In other legislation such as the Trade Practices Act ('TPA') the imposition of civil penalties is reserved for breaches of the Act's competition provisions and certain other matters but not in respect of a breach of a consumer protection provision, Under the UCCC, which is a consumer protection law, a credit provider can incur a civil penalty for a relatively minor breach of, for example, a disclosure provision. Because the provision of consumer credit by a bank is on a national basis, compliance systems and documentation is largely computer generated to reduce the risk of non-compliance. If a breach occurs this is likely to be on a national scale. Therefore, banks and their advisers have taken steps to ensure that their documentation is fully compliant to the finest of detail. The standard of proof in a civil penalty case is lower than for a criminal offence and arguably easier to establish a judgment favouring the regulator. Consequently, the civil penalty regime has added length and complexity to those documents. Customers have remarked on the length and complexity of UCCC credit contracts and this appears in some cases to have undermined objective of disclosure by creating a disincentive for customers to read the documentation.

It is noted that recently a discussion paper has been issued by the Ministerial Council on Consumer Affairs through the Competition and Consumer Policy Division of Treasury inviting submissions on proposals to create a civil penalty regime for breaches of the consumer protection provisions of the TPA and related State and Territory fair trading acts. The ABA believes this would be a regressive move and the ABA will be responding citing the UCCC experience.

Banks also provided estimates of how much time that senior management and boards devote to compliance and how this has changed over the past five to ten years.

Estimates of proportions of Board time devoted to compliance issues from respondents with banking operations ranged from 5% to 25%. All reported that this has significantly increased over the last five to ten years.

One bank reported that time spent on compliance by Boards was 25% and Senior Management 20%, respectively; 5 years ago it was 7.5% & 7.5% and 10 years ago 5% & 5% - a 500% increase over the decade.

One bank also predicted significant increases with the Executive Risk Committee and Board Risk Committee currently spending approximately 25% of time on compliance and regulatory matters. This is expected to increase to 40% with Basel II.

While some commentators may argue that this increase is justified, it highlights the increasing pressure on directors and those in senior executive positions to devote time to legal compliance matters at risk of distraction from strategic and operational matters.

3.3 Overlaps with regulatory regimes

3.3.1 Corporate governance and fitness & propriety of directors

Issue

Corporate governance practices and conduct of responsible officers have traditionally been regulated by ASIC and the ASX. Recently, APRA has issued revised draft prudential standards on corporate governance and fit and proper persons.

Discussion

To date, fitness and propriety of senior managers and governance of companies has been the primary responsibility of ASIC and the ASX. The proposed APRA Fit and Proper and Governance Standards impose a third layer of regulation. Without careful design, APRA's prudential standards may impose unnecessary additional compliance costs. For example, there may be differences in the definition of a "senior manager". The practical impact, for regulated entities of maintaining a dual system of regulation for people who hold senior positions, would be increased legal, administrative and compliance costs.

In addition, there is the matter of translating the ASX Principles, which adopt an "if-not, why-not" approach, into minimum prudential standards. For example, APRA is considering adopting the Principle in relation to "independence of directors"; however, APRA will have an expectation that banks would apply the concept as standard, rather than allowing banks to adopt an alternative approach more suitable to the nature and complexity of the business. Recently released statistics by the ASX on corporate governance reporting practices indicate a high level of compliance; however, this includes application of alternative approaches.

Conclusion

The ABA has made a detailed submission to APRA and continues to be in discussions with APRA regarding its draft prudential standards. The ABA has had an indication that APRA is further amending its Fit and Proper and Governance Standards to remove unnecessary overlaps, and to improve flexibility by using PPGs rather than the legally enforceable Guidance Notes to foster best-practice prudential compliance in these areas.

3.3.2 Mutual Recognition

Increasingly as financial services are operated on a global basis the reach of international regulation is extending to the same degree. The ABA would like to see the Government continue its efforts to seek harmonisation or mutual recognition of these laws particularly given the robust regulation of the Australian regulatory and corporate governance systems.

The ABA believes that ASIC and Treasury should take a more active role in advocating a position of mutual recognition with US regulators. Further, we should ensure that the Department of Foreign Affairs and Trade are also kept across these issues in order to influence outcomes.

Two key examples are provided below.

Example 1: Extra-Territoriality of Sarbanes-Oxley Act

Issue

The Sarbanes-Oxley Act has extra-territorial reach affecting certain Australian companies' activities in Australia.

Discussion

There are no rules which allow foreign companies to be exempted from the Sarbanes-Oxley Act. To get the permission to be listed on an American exchange or to raise funds from U.S. capital markets, foreign companies need to be registered with the Securities and Exchange Commission ('SEC') and comply with the Sarbanes-Oxley Act.

This affects a number of Australian corporates including the four major banks. The ABA would like to see greater recognition by the SEC and the Public Companies Accounting Oversight Board ('PCAOB') of Australia's home corporate governance regime. Australia's regime is comparable to the US regime.

To illustrate the issue, section 404 and rules adopted by the SEC require companies that file annual reports with the SEC to report on management's responsibilities to establish and maintain adequate internal control over the company's financial reporting process, as well as management's assessment of the effectiveness of those internal controls. Compliance is onerous. The number of controls that big companies must test and document can run into the tens of thousands. The internal control provisions are basically a well-intentioned means of restoring trust in financial reporting. Auditors must report on the company's financial statements, management's assessment and the effectiveness of the company's controls.

Example 2: Investment Advisors Act 1940

Issue

The SEC has introduced a requirement for managers of US sourced investor money to register as an 'Investment Advisor.' The requirement to register extends to Australian banks which source investor funds from the U.S.

Discussion

The Investment Advisors Act 1940 was amended in December 2004. New regulations have been introduced requiring all managers of U.S. sourced investor money to register as an 'Investment Advisor' with the SEC from February 2006. Registration as an investment advisor results in ongoing compliance requirements, as set out in the SEC Rules, including:

- A compliance plan (extensive document referencing SEC rules to policies and procedures detailing internal controls, including filing/updating of SEC forms).
- Regular reviews of compliance plan.
- A designated compliance officer.
- A Code of Ethics (that meets the requirements of the SEC rules and includes, conflicts of interest and policies regarding personal trading in securities, "soft dollar" arrangements, reporting to SEC of personal security trading, code violations, disclosure code to all employees).
- Proxy voting policies and procedures.
- Books and records with respect to U.S clients, and in some cases, for non-U.S. clients.
- Ongoing SEC examinations.

There are no rules which allow foreign companies to be exempted from the requirement to register as an Investment Advisor.

Some Australian banks and funds managers asked that ASIC approach the SEC to get relief from the requirement for Australian banks and funds managers. However, ASIC's response was that they were unable to assist.

The requirement to register will affect a number of Australian banks and fund managers. The ABA would like to see recognition by the SEC of Australia's own corporate governance regime, which is similar to the U.S. regime.

Conclusion (for both examples)

The ABA considers that a more harmonised approach to cross-jurisdictional regulation should be adopted. An alternative approach where Australian banks either comply with Sarbanes-Oxley Act or explain why they should not comply could help to facilitate reciprocal recognition in individual cases.

3.3.3 Overlap in reporting requirements to regulators

Issue

Banks report data to the Government and regulators that seems to be for similar purposes, however, there are problems with the timing of information requests and formats for information.

Discussion

Banks are regulated by a number of regulators resulting in, at times, requests for information that are essentially seeking the same data. However, the request is made in such a manner that the bank is unable to provide the data once or in the same format. For example, there are differences between information required by super trustees applying for an APRA licence and information that is already reported to ASIC. In this instance, APRA requests the information in its own format, so trustees have to rework existing information. Similarly, the RBA gathers data from banks to complete its assets and liabilities of financial institutions statistics, whereas APRA gathers data from banks to complete its performance of financial institutions statistics. In this instance, the RBA and APRA are requesting similar data, and while the presentation of the data publicly may be different, the data provided is essentially the same.

Conclusion

The ABA considers that as far as reasonable and practical, information reported to Government or regulators should be streamlined to remove unnecessary duplication of reporting, particularly where this requires banks to rework or represent data.

3.3.4 Regulation of superannuation

Issue

Regulation of superannuation is becoming increasingly complex and cumbersome. In terms of complexity and compliance cost, superannuation regulation is second only to taxation. In addition, there are potential inconsistencies, overlaps, duplications and gaps in the regulation of superannuation and wealth management.

Discussion

Firstly, superannuation trustees are regulated by both APRA and ASIC. APRA focuses on prudential regulation, whereas ASIC focuses on conduct of business regulation. ASIC administers both the *Corporations Act* and the *Superannuation Industry (Supervision) Act* ('SIS Act'), whereas APRA administers, amongst other statutes, the SIS Act. As both regulators administer elements of the SIS Act there is potential for inconsistent or overlapping policy.

The ABA recognises the challenges that APRA faces with regulating a broad superannuation industry. However, currently, industry is concerned with the manner in which APRA is considering administering the law in relation to obligations of superannuation trustees. For example, there may be tension between the *Corporations Act* and the manner in which APRA is interpreting section 52 of the *Superannuation Industry (Supervision) Act* ('SIS Act'). APRA seems to be interpreting the law in a manner that may require all superannuation trustees to impose asset concentration limits or asset diversification limits at the fund level.

This approach would restrict the ability for superannuation trustees to determine investment characteristics within their product offerings to maximise returns and diversify risks; restrict individual members (and their financial advisers) to match assets across portfolios within the superannuation and non-superannuation environment; and impede the ability for individual members (and their financial advisers) to tailor investment choices based on their own particular investment objectives, financial situation and needs.

Secondly, self-managed superannuation funds (SMSFs) are essentially regulated by the ATO. Currently, there are differences between how complying superannuation funds and SMSFs are licensed and regulated. This approach means that consumers may not be receiving professional financial advice, creating concerns with consumer protection and market integrity in the retail superannuation industry.

Conclusion

The ABA believes that the Government and regulators should ensure that the policy objectives for the superannuation system as articulated in the law are reflected in the administration of the law across the various financial services regulators. In particular, the Government should ensure that the roles of superannuation trustees and professional financial advisers are not unintentionally restricted and that the regulatory treatment for SMSFs is product neutral and that savings are prudentially and safely invested in all superannuation vehicles.

3.3.5 Tax legislation

Issue

Currently tax legislation is extremely complex and cumbersome. Legislation should be principles-based rather than highly detailed and prescriptive. The design of the tax system should move to the alignment of tax and financial accounts, and be driven by simplification of the system as a whole.

Discussion

Tax law in Australia is very complex, with two Acts for income tax, and relatively new GST legislation. The approach to legislation has generally been detailed and prescriptive, with legislation supported by ATO rulings and other interpretative instruments.

Determination of a principle or point of law by a taxpayer usually requires interpretation of a number of legislative provisions and existing rulings, and frequently, requests for new rulings or testing in the courts.

For the policy-makers, changes to the law require detailed consideration of a large body of existing law, with significant risk of unintended consequences.

A principles-based approach would deliver higher levels of simplicity, fairness, efficiency and certainty in the tax system, improve tax administration and provide correlative benefits to taxpayers.

A principles-based approach would probably require further authority to be given to the Tax Commissioner, with the use of an appropriate review mechanism on ATO determinations, and process improvement on ATO interpretation.

Conclusion

The ABA considers that a principles-based approach to new tax legislation, where feasible, would significantly benefit policy-makers, the ATO and taxpayers.

3.3.6 ATO & Treasury

Issue

The ATO tax policy function was moved to Treasury some years ago. The intention was to provide a clear separation and delineation between policy and administration.

In practice, however, the nature of the boundary is not clear to taxpayers, and there have been significant instances where banks have been caught in an apparent gap between ATO and Treasury – where neither agency takes full responsibility for resolution.

Discussion

For example, the ATO has raised the prospect that certain subordinated instruments may not be debt for tax purposes. The ATO has argued that this is because of the existence of solvency clauses which make payment of the amounts due contingent on the solvency of the issuer.

Another example relates to the Taxation of Financial Arrangements ('TOFA') proposals. The industry has been working with the ATO and Treasury on TOFA for some time. There is a resistance to aligning taxation rules with accounting rules –

we need to ensure that the Government minimises duplication and maximises consistency with other reporting requirements.

Conclusion

If the ATO is constrained by their inability to interpret the legislation anything but literally, then a safety valve is needed through:

1. Powers granting the Commissioner discretion to apply a pragmatic or policy-based approach.

2. Fast-tracked system of having issues dealt with by Treasury.

Ultimately, the ABA considers that a thorough review of taxation is required to remove the unnecessary complexity.

3.3.7 State and Commonwealth Evidence Acts

Issue

Commonwealth and States' evidence acts are not uniform which means that nationally operating companies such as banks cannot adopt nationally uniform document retention procedures.

Discussion

The Commonwealth and NSW have amended their Evidence Acts to repeal the best evidence rule (requiring the retention of the original document) and other States have issued practice notes taking a range of approaches to the status and use of electronic copies of documents.

Conclusion

A national policy on the status of electronic records providing consistent principles across all jurisdictions is needed to enable documentary evidence to be retained and stored efficiently so as to satisfy national evidentiary requirements.

3.4 Inconsistencies between regulatory requirements

In addition to comment provided in section 3.3 regarding particular overlaps and inconsistencies, the ABA provides the following comments on inconsistencies between regulatory requirements.

3.4.1 Consumer Protection Laws

Issue

There is emerging inconsistency about how the nine Australian Governments use fair trading legislation (Trade Practices Act in the Commonwealth) to drive consumer protection initiatives. This leads to national disuniformity in these laws and greater compliance burdens and costs for companies, such as banks that operate nationally.

Discussion

Commonwealth, State and Territory consumer affairs Ministers agreed in 1983 to adopt nationally uniform consumer protection legislation, with the objective of promoting efficiency and reducing compliance costs. The model chosen for the uniform scheme was the consumer protection provisions (Part V) of the TPA, which include general prohibitions against misleading or deceptive conduct in trade or commerce, as well as more specific prohibited practices. Each jurisdiction adopted these provisions in mirror legislation.

There is emerging inconsistency about how the nine Governments use their fair trading legislation (TPA in the Commonwealth) to drive consumer protection initiatives, despite the original intent, when the legislation was passed, to have consistent national laws there is a trend away from this intention. An example occurred in 2004 when NSW and Victoria introduced similar but inconsistent amendments to their Fair Trading Acts regarding telemarketing. These provisions were not replicated in the TPA or in other State and Territory acts. The NSW and Victorian governments have since invited submissions on the harmonisation of some of the differences between the two pieces of legislation which has been welcomed by the ABA. However, the point is that had this been done before enactment, banks and other businesses would have been spared the need to develop different compliance arrangements and to later bring those compliance arrangements into line with the harmonised provisions once they are made known by NSW and Victoria.

Parliamentary Secretary Pearce has committed to work with the Ministerial Council on Consumer Affairs ('MCCA') to achieve a nationally uniform consistent consumer policy framework.

Conclusion

The ABA believes that a mechanism to achieve the original intent is to revisit the 1983 agreement between the nine Governments to include positive obligations to ensure consistency in consumer protection laws, using the template model that is applied to the Uniform Consumer Credit Code ('UCCC').

3.4.2 Credit Card Marketing

[Note: Also see comments under section 3.2 on compliance costs as they relate to the Uniform Consumer Credit Code.]

Issue

The UCCC was intended to be a nationally uniform law for the regulation of consumer credit (subject to some limited individual State and Territory discretions, for example the setting of maximum permissible interest rates for Code regulated lending). In 2002 the ACT Fair Trading Act 1992 was amended because the ACT Government decided to support a private member's bill concerning the marketing of credit on credit cards. The legislation was not subjected to a regulatory impact assessment nor was the assumed market failure researched beforehand.

Discussion

The amendment applies to restrict ACT credit providers from providing offers of credit cards and increased credit limits on credit cards to ACT residents unless certain procedures were followed. The effect of this amendment has been to require credit providers to adopt different procedures in the ACT than for the rest of Australia which undermines the principle of national uniformity for consumer credit regulation under the UCCC. Data available from the Reserve Bank shows that the overwhelming majority of credit card holders are managing their credit card facilities satisfactorily appropriately. The ACT amendment did not take account of the overall market situation.

In 2005 and in recognition of the importance of national uniformity of consumer credit law, the NSW Government decided (quite correctly and appropriately in the ABA's view) not to support a private member's bill in similar but not exact terms with the 2002 ACT Fair Trading Act amendment. Instead the NSW Government has provided a briefing paper for the consideration of MCCA.

Conclusion

The ABA considers that these examples highlight the need for clear regulatory protocols so that governments cannot by-pass uniformity agreements by supporting a bill not of their own making or because the legislation would not directly amend consumer credit law under the UCCC.

3.4.3 Mandatory comparison rate

Issue

There is emerging evidence that the mandatory disclosure of the comparison rate ('MCR') for fixed term UCCC regulated lending is failing its objective to inform consumers of the cost of their credit facilities.

Discussion

The UCCC mandates disclosure by credit providers of the MCR in all advertisements for fixed term credit and to have available in branches and other places, where credit is available, schedules of loan amounts and terms containing the MCR.

The MCR was legislated into the UCCC almost three years ago on the basis that its effectiveness would be reviewed at the end of three years. That review is currently in train and is expected to be followed by an examination of whether the MCR could be extended to continuous or revolving consumer credit products such as credit cards and overdrafts.

Consumer experience with the MCR indicates that the MCR requirement can mislead consumers into believing the MCR is the interest rate of another credit provider not the credit provider making the disclosure. Further, there have been instances of manipulation of the rate by some providers charging fees in a manner that has the effect of lowering the comparison rate they disclose. There is a lack of consistency in approach to the MCR by State Offices of Fair Trading and Consumer Affairs. New Zealand had a MCR for over a decade before deciding to repeal the requirement because they found that it misled customers and was of little informational use.

The MCR was introduced in Australia without research into its likely utility and application in an Australian context.

Conclusion

The task for the current MCR review is to assess the value of the MCR disclosure and it is hoped the review will be instructive on the future of the MCR. Any proposal to extend the MCR to continuous or revolving credit facilities must be preceded by appropriate research into a model and how it would impact on consumers and industry.

3.4.4 Regulation of finance brokers

Issue

There is an urgent need for nationally uniform regulation of finance brokers. There are two issues of concern to banks. Firstly, despite some progress towards nationally uniform legislation, it has not yet eventuated. Secondly, the proposed legislation is expected to contain a restriction on a mortgagee such as a bank from enforcing its mortgage after default by the customer where the origination of the loan involved a finance broker.

Discussion

The regulation of finance brokers varies across the States and Territories, particularly in relation to the provision of home lending products. Western Australia, Victoria, NSW and the ACT have legislated to regulate brokers. South Australia, Tasmania, Northern Territory and Queensland do not have specific legislation to regulate brokers. NSW, Victoria and ACT legislation is similar focusing on disclosure requirements for brokers.

The NSW Office of Fair Trading is expected to soon release draft provisions to develop nationally uniform finance broker legislation.

The ABA supports regulation of finance brokers. However, the ABA believes that it is inappropriate for the power of a bank to enforce a mortgage where the debtor has defaulted to be restrained simply because a finance broker was involved in the origination of the loan on behalf of the debtor. This proposal has prudential and other credit risk implication for banks.

Conclusion

The ABA considers that the MCCA should expedite the process towards nationally uniform legislation and not adopt the proposed restraint on the exercise of the power of sale by a mortgagee.

3.4.5 Regulatory concessions to accountants/tax agents

Issue

Under FSRA, accountants have a limited (incidental) exception available to them from the licensing regime. This has created a competitively uneven position in the provision of financial services advice.

Discussion

Advice given by a registered tax agent is not financial product advice if the advice is given in the ordinary course of activities and is reasonably regarded as a necessary part of those activities (section 766B(5)(c)). Accountants have a number of exemptions where they may not be required to hold an Australian financial services licence. This means that the promotion of self managed superannuation funds ('SMSFs') can be done through an accountant and not through a licensed financial services provider. This has ramifications for market integrity (as SMSFs are regulated in a different manner, e.g. ATO, not APRA and ASIC) and consumer protection (as SMSFs are being promoted by people that do not necessarily have ASIC Policy Statement 146 (PS 146) qualifications; PS 164 organisational capacities, including dispute mechanisms).

Conclusion

The industry is currently considering the concessions given to accountants and tax agents and contrasting behaviours with that of financial planners, and believes the Government should reverse the exemption on competitive neutrality grounds. This is particularly the case in relation to SMSFs, where retail investors may be receiving information on superannuation from agents that do not meet professional financial adviser standards.

3.4.6 OH&S legislation

Issue

The nine Governments have separate and distinct occupational health and safety ('OH&S') legislation setting out minimum standards for employers across the Commonwealth, States and Territories.

Discussion

The myriad of OH&S statutes across Australia creates inconsistency which leads to additional costs and inefficiencies for national employers, such as banks. As the duties and responsibilities are inconsistent there is a risk to the health and safety of all employees and others in a workplace.

In particular, for example, NSW is different to the other States and Territories in a number of areas. Firstly, the Industrial Relations Commission (IRC) in Court Session determines cases. This means that the Supreme Court of NSW (except in relation to appeals against decisions for a death in a workplace pursuant to section 32A of the OH&S Act (NSW)) is not the arbitrator. It also means that the Court of Criminal Appeal is not at the apex of the criminal system, as the IRC also determines appeals.

Secondly, NSW is the only jurisdiction in Australia which permits unions to bring prosecutions for alleged breaches of occupational health and safety legislation. Unions are not required to demonstrate that the prosecutions are in the public interest.

Finally, the independence of prosecutors in NSW (whether WorkCover or union prosecutor) is bought into question by their ability to claim a moiety. No other jurisdiction permits the payment of fines to union or WorkCover prosecutors for OH&S prosecutions. There are no restrictions on the use of such payments.

<u>Conclusion</u>

In our submission to the NSW Government review of the OH&S Act (NSW), the ABA has made recommendations relating to procedural fairness as follows:

- OH&S matters should be returned to the jurisdiction of the courts, allowing the IRC to concentrate on industrial relations matters.
- OH&S matters should be taken by the Department of Public Prosecutions (DPP) to the Supreme Court of NSW. The Court of Criminal Appeal should be at the apex of the OH&S system.
- No moiety should be payable to a WorkCover prosecutor or union. These procedural issues potentially undermine the integrity of the OH&S system.

Ultimately, the ABA considers there should be national harmonisation of occupational health and safety legislation.

3.4.7 Workplace surveillance

<u>Issue</u>

There is an emerging trend to national disuniformity in workplace surveillance laws making compliance by industry more complex and costly. Such laws must strike an appropriate balance between the workplace and detection of fraud.

<u>Discussion</u>

NSW has introduced legislation strengthening the requirements on business around surveillance in the workplace. It is understood that NSW will be taking this to the next Standing Committee of Attorneys General ('SCAG') meeting to try to garner support for a national approach. Victoria has recently released a proposal from the Victorian Law Reform Commission for workplace privacy legislation. These kinds of measures could be counterproductive to banks' fraud prevention initiatives. The industry needs to be vigilant about fraud vs privacy issues, especially with increasing requirements at a Commonwealth level.

<u>Conclusion</u>

The ABA considers that SCAG should adopt a single model for workplace surveillance and privacy with appropriate recognition of the right of employers to protect their business investment against fraud and other loss.

3.4.8 Statutory trusts

Issue

There is a lack of national uniformity for the calculation and remittance of interest on business agency and trust accounts in Australia making compliance by banks more costly and complex.

Discussion

There are various statutes in the States and Territories that regulate the keeping of solicitors', real estate and other business agents' trust accounts. One of the common obligations is the requirement for solicitors and agents to pay client monies into trust accounts commonly maintained with banks and other ADIs.

The legislation which governs the calculation and treatment of interest earned on statutory trust funds is not uniform across the States and Territories. This imposes significant costs and compliance burdens on banks.

Conclusion

The costs and complexities which could be alleviated by having one standard for the treatment of statutory trust interest imposed nationally.

3.4.9 Personal property securities

Issue

The taking of security over personal as distinct from real property is unnecessarily complex due to individual Commonwealth, State and Territory laws that regulate the classification, lodgement and priority of these securities. The result is complexity, cost and legal disputation creating avoidable inefficiencies.

Discussion

For over a decade Australian academics have been seeking reform of Australia's laws relating to personal property securities ('PPS') on the grounds of efficiency, lower cost and legal simplicity and certainty.

The Australian Law Reform Commission reported in 1993 that reform should be undertaken in Australia.

The ABA notes that the Australian Finance Conference has been a strong supporter of law reform in this area.

The ABA has opposed law reform on the grounds that wholesale reform is unnecessary, would be costly to implement, would add to regulatory burdens and disadvantage banks in their business lending and security arrangements.

Recently, in 2005 the Commonwealth Attorney General has taken an interest in reforming the law of PPS in Australia on the ground of efficiency because reform would harmonise the patchwork of State and Territory laws into a single cohesive and consistent regime.

There are overseas models that can be drawn upon to inform the reform agenda including the U.S. Commercial Code, Canadian provincial legislation and recently New Zealand's PPS regime.

The Attorney General has conferred with the general counsel of the four major Australian banks which have given "in principle" support to the notion of PPS reform.

The ABA now supports, in principle, support reform of the law relating to PPS and to identify the conditions that member banks consider must be applied in proceeding ahead with PPS reform.

The ABA agrees that PPS reform should create efficiencies in the taking, registration, management and enforcement of PPS, reduce costs and legal disputation and harmonise PPS rules within Australia and with some overseas countries, particularly New Zealand.

However, there are some important considerations and conditions that banks require to be taken into account in supporting PPS reform that include a scoping exercise by the Productivity Commission to asses the true costs, benefits and impacts of reform, full consultation and national consensus on a legislative model, preservation of existing priority rights and an incentive pricing structure by governments for the registration process. The ABA notes that New Zealand has recently reformed its PPS laws.

Conclusion

The ABA considers that the Government, through SCAG, should consult with the finance and legal sectors to establish a plan for going forward with reform with particular focus on the New Zealand experience.

3.4.10 Conveyancing laws

Issue

There are inconsistent conveyancing laws across the States and Territories relating to:

- Stamp duty calculation;
- Mortgage registration; and
- The form of documents lodged with the relevant government agency.

This creates unnecessary costs and inefficiencies because there are eight different sets of requirements that nationally operating banks have to deal with. The effect is compounded when there are multi-jurisdictional transactions.

Discussion

The ABA is working to help implement a national electronic settlement and conveyancing system to standardise and make more efficient the current manual systems of conveyancing settlement and land titles lodgements. The Victorian government has developed an electronic system and will conduct a pilot of its system next year with the participation of five ABA member banks.

National facilitation of the development of an appropriate electronic conveyancing system has been enhanced with the establishment of a national office for the project. The project is also on the agenda of SCAG. The efficiency gain of electronic conveyancing cannot be achieved without a nationally applicable system and laws.

The inconsistency in calculation of stamp duty on mortgages creates costly inefficiencies. While harmonisation of the stamp duty legislation was a goal, and to some extent achieved, it has been eroded in recent times. The States' agreement to discard mortgage duty following the introduction of GST has been implemented in a haphazard and inconsistent manner, giving rise to internal operational issues for member banks.

Conclusion

The ABA considers that through SCAG or other national ministerial forums there needs to be continuing reinforcement of the notion of a nationally applicable electronic conveyancing system. Electronic conveyancing will provide an opportunity to look at stamp duty harmonisation.

3.5 Regulation that is out-of-date due to industry trends

3.5.1 Fraud Detection

Issue

Fraud and anti-money laundering ('AML') detection is hampered by privacy issues. Prevention of crime, particularly in relation to electronic transactions requires rapid and effective verification of identity.

Discussion

Australia must meet its international obligations in relation to AML and the control of terrorist financing. Efforts in these areas require very robust Know Your Customer ('KYC') programs.

Verification of identity and KYC may require swift exchange of information between parties involved in a financial transaction, and strict application of privacy principles has the capacity to hinder processes in this area.

Conclusion

When a suspicion of criminal or terrorist activity is formed, action on that suspicion must not be obstructed by privacy considerations. Electronic payment mechanisms can move funds rapidly, and banks must be able to act swiftly to delay or block payments.

FSAC has indicated their interest in improving the regulatory framework to facilitate the adoption and use of technologies in the financial sector, and in relation to the prevention of crime, there is a clear public interest in facilitating the application of technology.

3.5.2 Credit reporting under the Privacy Act

Issue

The credit reporting provisions of the Privacy Act (Part 111A) are preventing better credit default information being available for credit providers.

Discussion

There are some practical issues relating to the posting of credit default notices on credit reference agencies' credit reference files.

Under Part 111A of the Privacy Act credit providers cannot list an overdue payment with a credit reference agency (such as Baycorp) until it is 60 days old. It is common that when a demand is made for an overdue payment and the demand is not satisfied the credit provider will seek to list the debt together with the amount of interest and charges that have accrued since the demand, 60 days or more after the demand was issued.

The Banking & Financial Service Ombudsman and the Office of the Privacy Commissioner take the view that the credit provider must list only the amount demanded, and not subsequent interest and charges, because the interest and charges are not 60 days old at the date of listing. Credit reference files are relied on by credit providers to assess among other things any overdue amounts that a debtor may have incurred in relation to their credit provider(s). Unless all overdue amounts are able to be disclosed the credit reference file is incomplete which in turn impacts on the integrity of the file.

Conclusion

The ABA considers that the Privacy Act should be amended so that provided a credit provider makes it clear to the customer when the demand is made, interest and charges will keep accruing if the amount is not paid it should be permissible for the credit provider to list the amount actually owed at the date of listing.

3.6 Regulation hindering industry developments

The ABA makes some observations regarding the implementation of the Financial Services Reform Act ('FSRA').

Firstly, there was a delay in the decision as to whether banks would receive a streamlined licensing process.

Secondly, there was uncertainty as to the commencement of the new legislation and the transition period available for industry to apply for a new licence and comply with their new licensee obligations.

The original commencement date was 1 January 2001, reflecting a general lack of appreciation of the significant issues that industry was facing with introducing the legislation. Eventually the legislation was accented prior to the details of the regulations being issued for consultation and being finalised.

Therefore, while industry was supposed to be preparing for a new licence, they were in fact still making comment on regulations and other unintended consequences and operational implications of implementation. This resulted in changes being made to the legislation, contributing to ongoing uncertainty during the implementation and transition period.

3.6.1 Impact of FSRA

<u>Issue</u>

The FSRA, while streamlining licensing for financial products, has resulted in a ''one-size-fits-all'' approach to regulation across the spectrum of financial products, and to a certain degree, across the spectrum of consumers.

<u>Discussion</u>

Section 764A defines specific things that are a class of financial product. Furthermore, section 761G provides the meaning of a retail and wholesale client. The various statutory tests are generally contained in regulations and apply to individuals and small companies.

The FSR refinement project has, and is, going some way to address the restrictions of the "retail/wholesale distinction"; however, the arbitrary statutory tests have resulted in a contraction of the market for financial products for retail investors, or alternatively an increase in the cost of financial products for retail investors; for example, foreign exchange and other Treasury products being offered to retail customers - this includes risk management products for small business and over-the-counter (OTC) products being offered to individuals, both for the purposes of risk management or hedging exposures.

Other areas where FSRA is having an adverse impact on the bank-customer relationship is with disclosure and advice; for example, the disclosure regime is creating unnecessary compliance costs, particularly where there are changes made resulting in systems rebuild and additional printing and distribution costs. Another impact of the FSRA on the financial services industry is in relation to advice. Due to the compliance burden and administrative costs of providing advice, some banks have adopted a "no-advice" model for more simple products.

The ABA makes some further observations:

- Some employment agencies no longer supply staff for customer facing roles in financial institutions due to training obligations for more simple products.
- Low volume "legacy products" cannot continue to be supported due to high compliance costs, particularly due to systems rebuilds needed due to new requirements.
- Telephone call centre staff are required to make long disclosures to customers for basic products, increasing call time and ultimately cost.

<u>Conclusion</u>

The ABA is currently working with the Treasury and ASIC on the FSR refinements project. While the ABA is pleased that many of the concerns expressed by industry since FSRA transition have been included in the project, some significant concerns remain to be addressed going forward.

In addition, the ABA is in the course of providing specific comments to ASIC on some outstanding dollar disclosure issues.

3.7 Regulatory process and operations

The FICA Report makes twelve recommendations about improving regulatory processes. These are listed below, in short-form, along with ABA's views on each of the recommendations.

<u>Recommendation 1</u>

Government and regulators be encouraged to adopt light-handed models of regulation, following the policy framework adopted in the Wallis inquiry in the major reviews of regulations under way.

Supported

The ABA particularly supports the FICA Report's comments on implementation of regulation using the minimum level of market intrusion necessary to give effect to policy objectives.

Recommendation 2

Consultation should be comprehensively focused on ensuring the most cost-effective means to achieve the stated policy intent of any new or substantially modified financial sector regulations be undertaken at all stages of the development of the regulations i.e. when policy is designed, legislation is drafted, and the legislation is translated into specific regulations and procedures applied by the relevant regulator.

Supported

The ABA notes that the industry's major regulators have improved their consultative processes and do have their own consultative models in place already. However, the ABA believes that there can be improvements to consultative processes.

Recommendation 3

The business community continue to support a broad debate on the need for further microeconomic reform with the development of well-designed regulations being an essential element of that agenda.

Supported

The ABA notes the good work done by the Business Council of Australia ('BCA') report which canvasses economic reform agenda issues such as tax, regulation, infrastructure and workplace relations, to ensure the economy remains globally competitive and can continue to support strong job growth and rising standards of living.

Recommendation 4

For major pieces of financial sector regulation, the Government should release a statement of policy intent, initially in the form of its 2nd reading speech and thereafter following a post implementation review that would be conducted within two years to measure whether the objectives were being achieved in the most cost effective manner.

Supported

It is critical to check whether regulation has achieved its desired outcome. If it has not then steps can be taken to change it.

Recommendation 5

A Bureau of Financial Regulation be established to oversee financial sector regulation.

We do not support in the first instance

Although the FICA Report advocates the establishment of a Bureau of Financial Regulation, this could be seen as an additional layer of bureaucracy. We believe that at first instance, the Office of Regulation Review should be tasked with the suggested functions - with additional accountability and review mechanisms, for example, by requiring the Productivity Commissioner to issue a regular report to Parliament on regulation.

However, if it is not possible to achieve this change in the ORR, other alternative models could be looked at including the Bureau model as proposed.

Recommendation 6

The Bureau of Financial Sector Regulation should be tasked with the development of common methodologies to calculate the costs of complying with financial sector regulation on a regular basis. The Bureau should work closely with FICA (or the different industry associations) to help to ensure that this effort is as cost-effective as possible.

We do not support in the first instance (see comments in recommendation 5)

As noted above, the ABA believes that the Office of Regulatory Review should be tasked with enhancing and promoting the Government's objective of effective and efficient legislation and regulation, and to do so from an economy-wide perspective. The Office of Regulatory Review should be given a mandate to assist policy makers and regulators give closer consideration to quantifying the costs and benefits as part of completing Regulatory Impact Statements ('RIS').

Recommendation 7

The Bureau of Financial Sector Regulation should be given a mandate to lift the standards of the cost-benefit analysis of financial sector regulation, and be resourced adequately for this task. The Bureau should encourage a deeper understanding of best practice regulation.

We do not support in the first instance (see comments in recommendation 5)

The ABA believes that the Office of Regulatory Review should have enhanced capacity to influence policy makes and regulators fulfilling their RIS obligations.

Recommendation 8

The Government recognise the potential usefulness of regulated entities being able to develop their own compliance models to achieve regulator-specified outcomes. APRA and ASIC in particular be encouraged to refine what is expected of regulated entities and to develop a framework for alternative compliance models for specified areas of regulation.

Supported

The ABA considers that a model of principles-based regulation should:

- Ensure accountability for outcomes remains with regulators; but
- Allow for regulated entities to apply measures commensurate with the nature and complexity of their business.

International standards provide a precedent for applying principles, e.g. Bank of International Settlements has issued guidance on capital adequacy; APRA has issued guidance on implementing capital adequacy requirements through a value-at-risk (VAR) model. This means that institutions can determine what risks are weighted as commensurate with their business.

Recommendation 9

The Reserve Bank should be encouraged to reconsider its current approach to the regulation of interchange and explore less constraining means to encourage appropriate competition.

Supported

The ABA will provide a separate submission to FSAC and the Government's Taskforce on payments system reforms.

Recommendation 10

The Bureau of Financial Sector Regulation should have a mandate to monitor areas of duplication and inconsistency across regulators.

We do not support in the first instance (see comments in recommendation 5)

As canvassed above, we believe that at first instance, the Office of Regulation Review should be tasked with the suggested function - with additional accountability and review mechanisms

Recommendation 11

The Government should continue taking a lead in the developing of outcomes-based models of regulation in international forums. It should also encourage the recognition that regulatory frameworks may need to evolve as specific regulations are made operational. In adoption of international standards, Australian legislators and regulators should take due regard to the impact on international competitiveness of being an early adopter.

Supported

The ABA notes the work already done by Government e.g. ASIC through IOSCO and AUSTRAC through FATF.

Recommendation 12

That an independent review of the Wallis Inquiry be conducted with an emphasis on the appropriateness of its underlying philosophy and the implementation of its recommendations.

Noted.

The ABA believes that the current Government reviews of regulation (FSAC and Taskforce) be completed and assessed for effectiveness before any review of the Wallis Inquiry.

Although the suggested terms of reference in the FICA report are useful, if there is to be a review of the Wallis Inquiry we would recommend a focus on specific matters which by way of outcome diverged from the original recommendations of the inquiry. A key example of this would be the changes that have taken place to the payments system which, as already noted by this submission, will be the subject of a later submission to both the FSAC and Taskforce inquiries.

The ABA also notes that compliance and reform fatigue means there is little support to change the current regulatory framework, i.e. changing the "twin peaks" model of regulation and replace it with a 'super-regulator' like the Financial Services Authority in Britain.

3.8 Complaints or positive feedback

Anecdotally, the ABA has received feedback from industry participants and consumers about the impact of the FSRA, particularly regarding advice and disclosure. While some improvements have been noted, such as more consistent disclosure of conflicts and fees across industry, criticisms regarding the amount of disclosure now required to be provided to consumers continues to persist. The lack of recognition of applying product-risk across the spectrum of financial products is a contributing factor. It is not just industry that are finding the compliance burden untenable, but consumers are not tending to read all the material they receive, throwing into question the success of the FSRA. In addition, consumers have complained about the cost of professional financial advice. The lack of recognition of proportionality of advice in the law is a contributing factor.

However, the ABA notes that CPA Australia commissioned Investment Trends to conduct a survey of attitudes as to whether there have been improvements within the industry following the introduction of the FSR regime. The independent report indicates that consumers' views on the quality of advice offered, the clarity in which it is presented, and the effect of Statements of Advice (SOAs) are positive[7].

3.9 Experiences with regulators and Treasury

Generally, the experience of the ABA has been positive in terms of its dealings with regulators and the Treasury, and on matters of regulation. We have found the regulators and Treasury to be helpful, cooperative and generally consultative in their approach. Having said that, we still believe that it would help to improve consultation, as per the recommendation in the FICA Report, to ensure that emerging regulatory policy does not unnecessarily impede innovation and competition within the banking and finance sector.

The ABA acknowledges that building relationships is a two-way street. It is not satisfactory for an industry to complain about the approach of Government and regulators without making an effort to establish an effective working relationship.

One area of concern that the ABA holds is in relation to the operation of the Ministerial Councils of Commonwealth, State and Territory Ministers. These bodies are not good at consulting with industry – it is often left to industry to try and work out what is on the agendas of these meetings, to attempt to make input to the matters being discussed and to find afterwards the substance of what occurred beyond the official communiqué.

The bodies we refer to are the meetings of gambling, fair trading and small business Ministers in particular.

3.10 Other comments

The ABA has concerns with pending regulation.

<u>Issue</u>

The Government is considering introducing deposit insurance.

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7 http://www.cpaaustralia.com.au/cps/rde/xchg

<u>Discussion</u>

Currently, Australian deposit holders have a super priority in the event of failure – a priority that is above all other creditors, including secured creditors. No other country affords deposit holders this level of priority. In the U.S.A. and Germany, bank insolvency laws give depositors priority above general creditors, but below secured creditors.

Australia also has extensive laws covering institution governance, disclosure and transparency, and strong prudential powers that enable regulators to deal effectively with failures, for example, by allowing regulators to assume control of the company and organising mergers, buy outs or wind ups. Protecting depositors is the reason why prudential regulators have these extensive powers. It is also important to note that Basel II and the Sarbanes-Oxley Act further increases the burden of market disclosure and transparency.

Another feature of Australia's system is the self-regulated Interbank Deposit Agreement which requires major banks to provide up to $2 billion in short term liquidity if requested by another major bank. This means $6 billion can be secured at short notice to help with any liquidity problems that emerge. In the event the money is not repaid within 30 days, repayment can be made in the form of mortgage assets. The main benefit of this system is in assisting to stop a deposit run damaging an otherwise solvent institution.

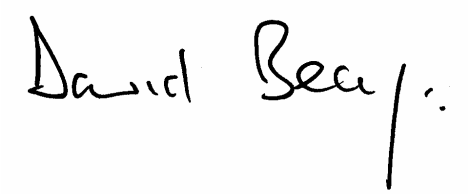
<u>Conclusion</u>

It is the ABA's view that deposit insurance is an unnecessary regulatory overlay, as the current system in Australia is more than adequate in protecting deposit holders and managing failures.

The ABA will be making a full submission to the Government's Regulation Taskforce.

The ABA would be happy to discuss any of the issues raised in this letter with you further.

Yours sincerely,



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David Bell

Enclosure:

1. Review of Business Regulation in Australia, November 2005, prepared by CRA International.