

SECOND READING SPEECH

FINANCIAL SERVICES REFORM BILL 2001

Today I introduce a Bill to modernise the regulation of the Australian financial services industry.

The Bill will introduce a harmonised regulatory regime for market integrity and consumer protection across the financial services industry.

The comprehensive package of reforms proposed in the Financial Services Reform Bill will facilitate the development of a financial services industry that is both globally competitive and consumer focused.

The reforms proposed in the Bill are at the cutting edge of global regulatory practice.

The Bill constitutes the third tranche of the Government's legislative response to the Financial System Inquiry (FSI) Report.

The FSI Report concluded that the complex and fragmented regulatory framework was creating inefficiencies for financial service providers and confusion for consumers.

It recommended the introduction of a single licensing regime for all financial sales, advice and dealing and the creation of a consistent and comparable product disclosure framework.

It argued that these changes would generate substantial benefits for both the industry and consumers.

This Bill is the vehicle that will enable financial service providers to reap the efficiencies and cost savings identified by the FSI.

It will do so by introducing a harmonised licensing, disclosure and conduct framework for all financial service providers.

It will establish a consistent and comparable financial product disclosure regime.

It will create a streamlined regulatory regime for financial markets and clearing and settlement facilities.

The Bill recognises that it is no longer possible for different financial institutions, services and products to be regulated under separate regulatory frameworks.

The Bill will ensure that Australia's regulatory framework keeps pace with current developments in the financial services industry.

The Bill will remove regulatory barriers to the introduction of technological innovations and assist Australia's financial services industry to meet the technological challenge posed by the spread of e-commerce.

It will ensure that Australian financial service providers that seek to compete in the global marketplace are not disadvantaged under Australia's domestic regulatory framework.

The streamlined regulatory regime proposed in the Bill will reduce the compliance costs associated with carrying on a financial services business.

The Bill will bring particular benefits to financial institutions that seek to provide their clients with a full range of financial services and products to their clients. However it has been carefully crafted to ensure that specialist providers and small businesses will not be disadvantaged.

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Consumers will benefit from the introduction of a consistent framework of consumer protection.

The Bill will enhance the capacity of consumers to understand and compare different financial products and evaluate financial advice. It will also ensure that consumers can access appropriate complaint handling mechanisms for resolving disputes with financial service providers.

Whilst most industry participants have welcomed this Bill, and many are keen for the new arrangements to commence at the earliest opportunity, a minority has resisted any change to the current regulatory arrangements. The Government has listened to the arguments of these industry participants, and has sought to address as many of their concerns as possible.

However, for the benefit of industry and consumers as a whole, it is necessary for these participants to move outside their 'comfort zone' and become part of a highly dynamic and rapidly changing financial services industry.

The Bill's overall objective is to harmonise, rather than increase the intensity of the current regulatory framework.

Many financial service providers are already subject to regulatory frameworks governing licensing, disclosure and other conduct obligations. However these frameworks vary across different industry sectors. This fragmentation increases compliance costs and reduces industry efficiency.

The Bill seeks to harmonise these diverse requirements within a single overarching framework that will apply to all financial service providers.

The Bill will replace a substantial amount of existing legislation, hence its size.

It is important to emphasise that harmonisation does not equal uniformity.

The new framework will protect individual and small business consumers without imposing higher costs on wholesale transactions between sophisticated professional investors that operate in a competitive global market.

The framework will also be capable of flexible implementation so that it can apply differently to different products where this difference can be justified within the overall objectives of the regulatory framework.

Basic deposit products will be subject to less intensive regulation than more complex investment products.

This will ensure that the Bill will not jeopardise the cost-effective provision of basic banking services, especially in rural and regional areas.

The Bill will also provide financial service providers with the flexibility to adopt corporate structures and distribution channels that best meet their commercial objectives.

Furthermore, it is anticipated that industry codes will play an important role in fleshing out standards for meeting the requirements of the new regime.

The Bill is the product of an extensive process of consultation that has been widely applauded by both business and consumer representatives.

Discussion papers setting out the major reforms proposed in the Bill were released for public comment in December 1997 and March 1999.

An exposure draft of the Bill was released for public comment in February 2000. Over 120 submissions were received in response to the exposure draft.

This exposure draft was also considered by the Parliamentary Joint Committee on Corporations and Securities, and I thank the members for the Committee for their report.

I would also like to thank the members of the Government's Business Regulation Advisory Group for their participation in the consultation process.

The Bill has been refined in response to issues identified by stakeholders as well as by the Parliamentary Joint Committee on Corporations and Securities and the Business Regulation Advisory Group.

In addition, I have consulted the relevant State and Northern Territory Ministers about these reforms in accordance with the Corporations Agreement and have obtained the approval of the Ministerial Council for Corporations for those amendments included in this Bill for which the Council's approval is required under that Agreement.

I will be asking the Parliamentary Joint Committee to consider the final form of the Bill that I am introducing today, focussing particularly on the changes that have been made and other elements of the Bill that have not previously been considered.

Coverage of the regime

The Bill will cover a wide range of financial products: shares and debentures, derivatives, managed investment products, general and life insurance products (other than health insurance), superannuation products and Retirement Savings Accounts, deposit products, non-cash payment facilities and some foreign exchange transactions (where contracts are not settled immediately).

Credit will be expressly excluded from regulation under the Bill. Consumer credit will continue to be regulated under the Uniform Consumer Credit Code (UCCC).

Financial service provider licensing

A person who carries on a financial services business will be required to hold an Australian Financial Services Licence.

A licence can be sought to provide all financial services in relation to all financial products or a more limited class of services and products. The licence criteria will be applied having regard to the scope of the licence being sought.

Licensees will be able to authorise natural persons or corporate representatives to act on their behalf. However licensees will be responsible for the conduct of their representatives.

The new licensing provisions have been carefully crafted to accommodate existing representative structures. They will provide industry participants with the flexibility to structure their distribution arrangements in a manner that best meets their commercial objectives.

The Bill contains a mechanism for professional bodies, whose members in the course of carrying on their profession give financial product advice, to come within the licensing regime through a mechanism referred to as the Declared Professional Body.

Financial service provider disclosure and conduct

The financial service provider disclosure obligations contained in the Bill will ensure that retail clients receive sufficient information to make informed decisions about whether to take up a financial service and whether to act on the advice they receive.

In particular, advisers will be required to disclose information on any conflicts of interest, including commissions, that might reasonably be expected to influence the advice provided. Additional

requirements will apply where advice recommends the replacement of one financial product with another:-

These provisions, particularly as they apply to risk insurance products, have been the subject of much debate in the consultation process. Modifications have been made to the original proposals.

There are still some in the industry who oppose the approach adopted in the Bill. However I remain convinced that we have got it right. To go further would compromise one of the key objectives of the Bill of moving away from inefficient product-based regulation to a harmonised regulatory framework across the financial services industry.

Financial product disclosure

The Bill will establish a regime for disclosure throughout the life of a financial product: from point of sale disclosure, to confirmation of transactions, ongoing disclosure and periodic reporting.

In relation to point of sale disclosure a dual approach is taken. Shares and debentures will remain subject to the fundraising provisions that are contained in Chapter 6D of the proposed Corporations Act. These provisions were recently reformed by the *Corporate Law Economic Reform Program Act 1999* and it would have been inappropriate to subject them to further change.

All other financial products, including managed investment products, will be subject to a new point of sale disclosure framework based on a Product Disclosure Statement.

The Product Disclosure Statement will be required to provide retail clients with key information relevant to a particular product as well as any other information that is known to the issuer that might reasonably be expected to influence a retail client's decision to acquire the product.

The Bill's approach to financial product disclosure is intended to ensure that retail clients receive sufficient information to make informed choices in relation to the acquisition of financial products and that this information is provided in a concise and readily understandable format that facilitates comparisons between financial products.

The Bill will also require product issuers that are not licensees to provide retail clients with access to internal and external dispute resolution procedures.

Markets and clearing and settlement facilities

The Bill introduces a simplified approach to the regulation of financial markets and clearing and settlement facilities.

The seven routes to authorisation for securities and futures exchanges under the current Corporations Law will be replaced with a single licensing regime based on the Australian Market Licence. Similarly the two current routes to authorisation for clearing and settlement facilities will be replaced with a single Australian Clearing and Settlement Facility Licence.

The new regulatory structure contained in the Bill will clarify the roles and responsibilities of market and facility operators, the Minister and ASIC.

Under the new licensing arrangements, licensees will have primary responsibility for the operation of markets and facilities.

The Minister will have overall responsibility for licensing financial markets and clearing and settlement facilities.

ASIC will be empowered to advise the Minister in relation to the Minister's licensing responsibilities under the new framework and the Minister will be required to have regard to

ASIC's advice. ASIC will also be required to undertake annual assessments of the adequacy of market and facility licensees' supervision arrangements and will assess their compliance with their obligations under the new regime.

The Bill will provide market operators with greater flexibility in developing market supervision and compensation arrangements to meet their obligations under the new regulatory regime.

The compensation arrangements in the Bill are largely based on existing provisions in the Corporations Law. However, during the consultation process fundamental issues arose about the approach to compensation arrangements. Given the significance of the issue, I have asked the Companies and Securities Advisory Committee to consider the matter, with a view to implementing further changes, if necessary, in the future.

Given structural changes in clearing and settlement, both in Australia and globally, I am considering how best to ensure that the Reserve Bank of Australia has an appropriate role in relation to systemic risk matters. I propose to consult with clearing and settlement facilities before introducing some amendments to the provisions of the Bill that regulate clearing and settlement facilities in the Winter Sittings.

The Bill will apply a 'fit and proper' test to a range of persons involved in licensed financial markets and clearing and settlement facilities.

The current five per cent shareholding limitation applying to the Australian Stock Exchange Ltd will be removed. In its place, the Bill applies a shareholding limitation of 15 per cent to financial markets and clearing and settlement facilities that are prescribed as being of national significance. However it will be possible for the Minister to approve a larger shareholding in relation to a market or facility where this is in the public interest. The explanatory memorandum to the Bill contains guidelines for assessing whether a market or clearing and settlement facility is of national significance.

Market and other misconduct provisions

The provisions relating to market and other misconduct in the current Corporations Law will be streamlined and extended, as appropriate, to apply to all financial products and markets.

A number of market misconduct provisions will become civil penalty provisions. This means that contraventions will be subject to both civil penalties and criminal consequences.

Telephone monitoring during takeover bids

The Bill will amend the regulatory framework covering takeovers to provide greater protection for target shareholders. It will require bidders and targets to record all telephone conversations with target shareholders during the bid period. Privacy safeguards to protect the information will also be required.

This measure will enhance ASIC's capacity to investigate and take enforcement action in these situations.

Commencement of the regime

The Government had been aiming for commencement of the regime on 1 July 2001. However, the delay in introduction of the Bill while we negotiated a secure constitutional basis for corporate regulation with the States now means that this is no longer possible.

We need to allow sufficient time to consult on the regulations under the Bill and for the Australian Securities and Investments Commission and industry to prepare for commencement. Following

passage of the Bill I will be consulting with interested parties to determine an appropriate commencement date.

The proposed transitional provisions relating to the commencement of the new regulatory framework will be contained in a separate Bill dealing with transitional and consequential amendments that I intend to introduce in the Winter Sittings.

A two-year transitional period will generally apply in relation to the new regulatory framework.

To facilitate a smooth transition to the new regime, existing licensees will generally be able to exchange their current licence for a new licence enabling them to carry on their existing businesses.

Existing licensing and registration regimes will be preserved during the transitional period and will continue to apply to persons until they transition to the new regime.

In relation to the potential tax consequences for current industry participants in moving to the new licensing regime, the Government is calling for submissions from industry to determine the precise nature and extent of the issue. These submissions need to be submitted by 31 May 2001. Following an assessment of these submissions, the Government will consider whether legislation is necessary to deal with any identified tax consequences of the FSR Bill.

In relation to product disclosure, there will be a two-year transitional period. However a product issuer or seller may opt-in to the new regime at any time during the transitional period.

In relation to superannuation products that will be subject to the choice of fund regime, special transitional provisions will be prescribed in regulations once the timing of choice legislation is known.

Existing approved exchanges will be issued with a licence under the new regime that will permit them to carry on the activities for which they are currently authorised. However approval would be needed to undertake new activities.

The operators of markets which are subject to exempt market declarations will have two years in which to obtain an Australian Markets Licence.

A similar transitional regime will apply in relation to clearing and settlement facilities, except that those facilities that are currently operating but do not currently require approval will have two years to obtain a licence.