



Investment and Financial Services Association Limited

Towards a more efficient regulatory system: 2008-2011

A photograph of a modern building's interior, featuring large, cylindrical columns and a complex, multi-layered ceiling structure. The lighting is dramatic, with strong shadows and highlights. A semi-transparent, dark grey geometric shape is overlaid on the right side of the image.

strength through association



## About IFSA Our Mission

**IFSA's mission is to play a significant role in the development of the social, economic and regulatory framework in which our members operate, thereby assisting members to serve their customers better.**

IFSA seeks to fulfil this mission by:

- being open, transparent and collaborative
- encouraging ethical and equitable behaviour by members through the development of industry standards
- achieving simple and efficient regulatory regimes
- creating level playing fields and competitive markets
- contributing to a strong national economy by encouraging savings and improving the opportunities for achieving personal financial independence.

The IFSA Board of Directors have established nine Board Committees to focus the work of IFSA in achieving this mission<sup>1</sup>. This IFSA Regulatory Headland Statement is issued by the Regulatory Affairs Board Committee (RABC), one of the nine IFSA Board Committees.

RABC is responsible to the IFSA Board for developing strategies and policies on regulatory issues affecting the financial services industry. The Board Committee interacts with the other IFSA board committees on areas of common interest and engages Government and our financial services regulators (ASIC, APRA and AUSTRAC) to improve regulation in Australia and assist in the efficient operation of the financial services industry.

## CEO's Review



This IFSA Regulatory Headland Statement, Towards a More Efficient Regulatory System: 2008 – 2011, proposes an approach to, and program for, legislative reform to address structural weaknesses in our regulatory systems that have been identified by IFSA member companies.

This Headland Statement builds on the five recommendations made in the earlier 2006 IFSA Statement<sup>2</sup> which focussed on the style and cost of regulation. In the 2006 Regulatory Headland Statement, IFSA recommended that:

- every effort should be made to ensure that the drafting of legislation should be principles based (Recommendation 1 - Principle Based Legislation);
- greater use and reliance be placed on Industry Codes of Practice as a regulatory tool. This should be done in conjunction with principles based legislation (Recommendation 2 - Industry Standards);
- a formal consultative process be established for proposed Government legislation and regulations, and for standards, class orders, guidelines, policy statements and practice notes issued by regulators that have broad application to the financial services industry (Recommendation 3 – Formal Consultative Process);
- a Financial Services Committee be established on a permanent basis to consider draft regulatory reforms and provide to Parliament its comments and/or endorsement of regulatory proposals (Recommendation 4 – Financial Services Committee); and
- any future regulation of the financial services industry adopt a more rigorous and broader risk/benefit based approach to financial services regulation (Recommendation 5 - Risk/Benefit Approach to Regulation).

Those recommendations continue to be relevant and, to the extent they have not been adopted, continue to be necessary for an effective and efficient regulatory system. Certainly, there have been significant improvements in regulator consultation and the appointment by ASIC of a Chief Economist is a positive step towards the implementation of a more rigorous risk/benefit based approach to the regulation of financial services. Additionally, the current Government in establishing Advisory Panels<sup>3</sup> to provide to industry policy and technical input for specific reform proposals, is a positive consultative development.

In conclusion I thank the Regulatory Affairs Board Committee (RABC) for their work in progressing this initiative.

A handwritten signature in black ink, appearing to read 'Richard Gilbert', written in a cursive style.

Richard Gilbert  
Chief Executive Officer





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## 1. A Platform For Reform

In this Headland Statement for the period 2008-2011, IFSA has made seven recommendations focussing on areas of structural weakness that impede the efficiency of financial services in Australia. Recommendations are made on:

- Benchmarking Australian Regulation
- Operational Efficiency
- Financial Projections
- Industry Data
- Industry Structure
- Regulator Accountability
- Industry Standards

## 2. 10 Years Of Reform

The last 10 years of reform has placed Australia in a better position to address the challenges of a modern economy and global competition. However, the fine-tuning of our law and its policy underpinnings remains a priority for IFSA members. While significant steps have been taken to improve the efficiency and integrity of the Australian financial services industry further work remains to be done.

The 1997 Financial System Inquiry<sup>4</sup> (Inquiry) focussed the minds of our legislators on delivering a regulatory regime that was capable of adapting to technological change, globalisation and consumer needs into the 21st Century. The Financial Services Reform Act 2002 (FSRA) brought about fundamental structural reform to Australia's financial services laws and replaced a piecemeal legal framework with a harmonised regulatory regime.

The FSRA reforms were market and customer-centric. Implementation of FSRA by the financial services industry involved a significant investment in, and commitment to, the future regulation of the industry. While there have been a series of refinements to the law post FSRA, IFSA considers that certain matters continue to highlight some structural weaknesses in the law that impede both economic and operational efficiency in the financial services industry. These impediments also negatively impact consumers.

## 3. Industry Issues

Government has responsibility for ensuring that the legislative structures underpinning business enterprise in Australia achieve a balance between business facilitation and investor protection. If that balance is achieved, benefits will flow to the broader Australian community.

The benefits of legislative success are commercial certainty, industry efficiency, and the confident and informed participation of financial service providers and their customers. Ideally, this should be achieved through a regulatory system that combines substantive legislative requirements and industry self regulation.

IFSA members are concerned, despite refinements made to the law to date, that certain requirements of the Corporations Act 2001:

- are limiting business efficiency and customer preferences by impeding the effective use of technology;
- have not kept pace with market developments or the challenges of global investment markets;
- are uncertain and require clarification;
- distort service provider and customer behaviour.

The recommendations made in this Headland Statement identify specific industry concerns, some of which are being addressed by the Rudd Labor Government.

### 3.1 Benchmarking Australian Regulation

Australia operates as part of a global economy and our regulatory regimes influence our ability to compete effectively both domestically and internationally. In a competitive market it is necessary that we continuously review and strategically

evaluate our current laws. Australian business and investors are right to expect that our regulatory system is directed at placing them in the best possible productive position to enhance their functional performance and for businesses to compete in areas where they choose to compete. Benchmarking our performance to other successful jurisdictions will highlight areas where Australia can improve.

Australian financial regulation, particularly our superannuation system, is a model for our region<sup>5</sup>. Real success for Australia will come from co-ordinated strategic responses to the challenges presented by domestic and global markets. However, any lack of co-ordination of strategic priorities runs the risk of diminishing our success.

The Rudd Labor Government has been active in the implementation of the 2007 Labor National Platform<sup>6</sup> to expand financial services exports by improving taxation and marketing arrangements. IFSA supports Labor policy recognising “Australia’s comparative advantage in funds management”, and its policy to “ensure that Australia has appropriate policy settings and marketing to position Australia as a funds management hub in Asia”.

Benchmarking Australia’s regulatory requirements and business performance to world best practice is a measure of success in areas where Australian business chooses to compete. A best practice strategy will enable Australia to:

- reduce costs and become more efficient
- use technology more effectively
- become more competitive
- respond more quickly to innovations.
- increase sales and develop new markets.

IFSA is supportive of the current Government initiatives that include a review of the Foreign Investment Fund regime, the review of

Division 6C of the Income Tax Assessment Act 1936 rules on Public Trading Trusts and the broader review of the tax arrangements applying to managed funds<sup>7</sup>, and the Budget commitment on Australia’s non-resident withholding tax regime<sup>8</sup>.

Tax reform is a key part of current initiatives to optimise functional efficiency in the financial services industry. It is also essential to Australia’s aspirations as a regional financial services hub and for the export of Australian financial services.

**IFSA recommends** that tax reform initiatives continue to feature as a priority in a co-ordinated response to both domestic and global challenges to Australian competitiveness.

### 3.2 Operational Efficiency

Regulation underpins the operations and performance of IFSA members. Even minor regulatory changes will usually involve some change to technology and operational systems that affect the delivery of financial products and services to investors. Appropriate regulation is, therefore, fundamentally important to industry efficiency and long term financial returns to investors.

IFSA members consider that significant operational gains and efficiencies can be achieved through improvements in and amendments to the law in the following specific areas:

- All regulated documents should be able to be accessible and issued electronically to investors at no cost unless a person otherwise requires a paper document. (see 3.2.1)
- Effective disclosure and shorter disclosure documents:
  - Remove residual impediments to the use of incorporation by reference;

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- Review the mandatory PDS content requirements;
- Extend incorporation by reference to other regulated documents eg FSGs and IDPS Guides. (see 3.2.2)
- Facilitating financial product rationalisation. (see 3.2.3)
- Allowing the disaggregation of the fiduciary interests of public offer investment funds from conglomerate corporate interests. (see 3.2.4)
- Duplicative requirements under the AML/CFT law should be avoided and the law should have a risk based focus with principles based requirements. (see 3.2.5)

### 3.2.1 Access to technology benefits

One of the aims of FSRA was to facilitate the use of technology-driven solutions to satisfy the legislative disclosure requirements. In this regard, the second reading speech stated that:

*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.*

While it is encouraging that Government has acknowledged the widespread adoption of information technology and endorsed recommendations for default electronic distribution of Annual Reports, the matter of electronic distribution has continued to be met with caution by the regulator and Treasury<sup>9</sup>. This has not provided product issuers with confidence that the law affecting electronic distribution of most regulated disclosure documents may be interpreted as supporting electronic distribution as the default, with hard copies to be provided upon request.

IFSA recommends that the Corporations

Act expressly provide that all regulated documents may be provided to customers by electronic means. Paper based documents would be provided on request of the customer.

### 3.2.2 Effective disclosure and shorter documents

Currently, the financial services industry operates in a prescriptive and largely rules based disclosure environment, where the presentation of information in documents such as Product Disclosure Statements (PDS) and Financial Services Guides (FSG) is a key to consumer protection.

IFSA's recent research project 'Super Decisions: Communicating with customers and effective disclosure'<sup>10</sup>, showed that many of those who are making a decision in relation to their super, do read the PDSs. Unsurprisingly, those that read the PDS are more likely to be comfortable with their decision than those who don't. The research also indicated that PDSs should be shorter in length, better presented and written in plain English. Further research conducted this year for IFSA showed that investors had a clear preference for PDSs that were 15-20 pages long. At this length they were perceived to be a more manageable and useful document<sup>11</sup>.

The content requirements of PDSs have presented significant challenges to industry in its efforts to streamline them. Following repeated industry calls for relief to facilitate the shortening of documents, the Government made regulations allowing Statements of Advice (SOAs) and PDSs to incorporate certain information into the document by reference to a separate document in which that information is contained. Certain core information must be included in a PDS and cannot be incorporated by reference<sup>12</sup>.

IFSA members support the idea that the role of the PDS should be to introduce the

investor to core details of the product and that investors should be clearly signposted to non-core information, which should be equally readable. While the incorporation regulations were welcomed by industry, their use has been limited by practical difficulties as a consequence of current limitations in the law. Those limitations include issues around record retention, unique identifiers, updating 3rd party information, clear concise and effective requirements, and liability for 3rd party information. IFSA proposes to issue a series of Guidance Notes to assist its members in the development of succinct disclosure documents to more effectively engage investors.

IFSA acknowledges the positive recent steps taken by Government in the establishment of the Financial Services Working Group to focus on shortening disclosure documents. We recognise the need to provide shorter, more succinct disclosure documents to enable the investor easier access to useful, understandable and relevant information to assist in their investment decision. We consider that the ability to incorporate by reference should also be extended to Financial Services Guides and IDPS Guides.

IFSA recommends that practical barriers to the use of incorporation by reference be identified and addressed, and that industry work with Government to establish a regime that permits more effective disclosure to investors.

Additionally, IFSA considers that there is a need to review mandatory PDS content requirements such as that prescribed by Schedule 10 of the Corporations Regulations – Disclosure of fees and other costs - to ensure that the disclosure requirements, and the form of disclosure, are appropriate and not misleading to consumers. The purpose of the requirements under Schedule 10 was to simplify the disclosure of fees and costs and allow for more effective comparison across products. It is questionable whether

this has been achieved.

The regulations mandate the inclusion of:

- A standardised 'Fees and costs template'
- 'Additional explanation of fees and costs section'
- 'Example of annual fees and costs table' based on a balanced investment option for a specified account balance and level of contributions.
- 'Consumer advisory warning box' alerting consumers to the importance of value for money and the compounding value of fees and costs and their impact over time on end benefits.

Given the aim of both industry and Government is to shorten the length of product disclosure statements and to maintain a robust and effective disclosure regime, such mandated disclosure must be effective and not misleading.

IFSA recommends that mandated disclosure required by Schedule 10 of the Corporations Regulations should be reviewed to ensure that such disclosures are effective and not misleading.

### 3.2.3 Product rationalisation

The law provides a framework within which financial products can be developed and offered to customers. Various amendments to the law, taxation and technological advances over the last 20 years have meant many products lack the features and functionality of today's financial product offerings. Given that financial products are designed and created at a point in time in a particular legislative and technological environment, products will, over time, become outdated and difficult to maintain. Where customers are in outdated and uneconomic products, it should be possible to close those products and move customers to a similar more modern product

with more flexibility and modern features.

Product rationalisation is needed to assist industry efficiency. Associated benefits to customers include enhanced product competitiveness, improved disclosure, improved safety, reduced operational risks, access to innovative investment opportunities, and reduction in costs. If a simplified process enabling financial products to be rationalised is not introduced, the costs to the financial services industry and its customers will increase significantly as the number of available financial products increases.

IFSA made a comprehensive submission to Government in 2005 calling for legislation to facilitate product rationalisation. Treasury released an Issues Paper for consultation on 22 June 2007 and the Government has established a Product Rationalisation Advisory Panel to advance this matter.

#### **No customer disadvantage**

Customers should not be disadvantaged by a product rationalisation. Where it is not possible to move a customer to a similar more modern product, the customer should be compensated financially. The IFSA submission proposed that a customer "no detriment" rule should apply and that complaints resolution procedures should be available to dissatisfied customers.

**IFSA recommends** that legislation implementing a regime that facilitates financial product rationalisation be introduced into the Parliament in 2008.

### 3.2.4 Disaggregation – Review of Takeover Provisions

The takeover provisions of Chapter 6 of the Corporations Act need, in our view, to be amended to facilitate market efficiency and to remove legal impediments that restrict the potential financial returns to investors in

Australian managed funds.

The current provisions in the Act, coupled with the growth in the Australian managed funds market have made it increasingly difficult for entities to stay below the existing 20% threshold and unduly limit the market for control. In addition, conglomerate financial institutions have to stop all trading in the securities in a bidder in lead up to a takeover bid (which can be for several months), even where that trading is at arm's length and completely unrelated to the bid. In essence, we believe that the laws are no longer up-to-date given the size and nature of Australian (and overseas) financial institutions.

The current Chapter 6 takeover provisions currently operate in a manner that is detrimental to:

- productive commercial activity;
- the interests of members in Australian superannuation funds, managed investment schemes and life insurance companies; and,
- the economy generally.

Australia, with a takeover threshold of 20%, is currently out of step with jurisdictions such as the USA, United Kingdom, Canada, Hong Kong and Singapore where the threshold is 30%. In addition, while there are differences in the takeover laws of the respective jurisdictions, each of these also permit disaggregation of holdings in specified circumstances.

The current 20% takeover threshold should be reviewed and, replaced with a more sophisticated takeovers regime that better recognises the nature and operations of today's conglomerate corporate groups. Such groups carry on a range of independent businesses and the fiduciary businesses and holdings of an entity should be considered separately for the purposes of the takeover threshold requirements. Addressing these and other related regulatory issues is important to

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maintaining Australia's competitiveness in the region, particularly as an attractive location for fund managers to operate.

**IFSA recommends** that the takeover requirements of the Corporations Act be amended to enable the disaggregation of associate interests where the acquisition and holding of the interests are held in a fiduciary capacity for a public offer managed investment scheme.

### 3.2.5 Anti-Money Laundering and Counter Terrorism Measures

IFSA supports the AML/CTF principles for the prevention of money laundering and terrorist financing. Our members are committed to an efficient and effective anti-money laundering regime. We continue to support a robust risk based framework for the AML/CTF Act which allows businesses of different sizes and complexities to develop systems that meet the level of risks and the changing situations and circumstances that they are likely to experience. Overly prescriptive rules and regulations will undermine this flexibility. It is important that where possible legislative requirements remain principles based.

The AML/CTF rules impose significant regulatory burdens on industry and are being imposed across different industry sectors in 2 tranches, the first tranche of legislation covering the financial services sector. IFSA had previously voiced concerns about any duplication of requirements for the designated services covered by the different tranches. The possible application of the Tranche 2 requirements to financial advisers already covered under Tranche 1 is an example of duplication that should be avoided<sup>13</sup>. The treatment of financial advisers under the AML/CTF Act was a very carefully considered policy decision undertaken in consultation

with the financial services industry.

**IFSA recommends** that the application of duplicative requirements under the AML/CTF law be avoided and to the extent possible, that the law continue to have a risk based focus and that those requirements be principles based.

### 3.3 Financial Projections

Saving for retirement is a long term endeavour and fundamentally important to the individual. The Australian superannuation system is one that requires the majority of superannuants to be actively involved in their planning for retirement and to understand what level of savings they need to achieve a specified level of income in retirement.

To assist individuals planning for retirement IFSA members broadly support the use of member benefit projections within superannuation statements. However, a number of issues would need to be addressed before member benefit projections would be offered by IFSA members. These issues include:

- determining an approach that is easily implemented by superannuation funds and meaningfully applied by investors so that the policy meets its stated objectives.
- reducing the risk to superannuation funds of future liability associated with offering investors something that may be interpreted by a customer as a 'perceived promise of benefit'.
- providing a framework for the illustrations that take into account the fact that investors will have:
  - different asset allocations;
  - different fee structures;
  - different contribution rates/frequencies; and

- different retirement objectives.

- Understanding all the upside and downside challenges associated with introducing member benefit projections.

The law does not expressly permit member benefit projections and we doubt that they were contemplated when the law was made. However, regardless of whether an interpretation of the existing law could be stretched to accommodate member benefit projections, such a move would not provide a sound basis and framework for the provision of member benefit projections. As such member benefit projections are unlikely to be broadly made available by industry unless a legislative framework sets out the operational parameters, responsibilities and protections.

The potential for a UK mortgage endowment type debacle should be avoided. In the UK, the mandated use of projection rates in communications to mortgage endowment customers, pre and post sale has caused significant reputational damage to the industry.

Mortgage endowments were sold with the aim of providing a lump sum at the end of a set term which was normally equal to the term of the mortgage. The hope was that the fund had grown, through regular contributions and investment returns, to a level equal to or more than the value of the outstanding mortgage. In many instances the projections developed at the point of sale were seen by investors in mortgage endowments as a 'promise of benefit'.

During the prolonged bear market of the early 2000s many investors began to see, through the projection in their annual statements, that it was unlikely that their funds would grow to the levels hoped for. As a result many customers claim to have been mis-sold the policies and the UK industry paid over £2.7bn in compensation to the end of 2006<sup>14</sup>.

**IFSA recommends** that Government initiate a review to examine the need for legislative

reform to provide a framework for the provision of member benefit projections in superannuation.

## 3.4 Industry Data

At 31 March 2008, total consolidated assets of managed funds institutions was \$1,270.9 billion<sup>15</sup>. IFSA member companies manage approximately 95 per cent of that total.

It is fundamentally important to the financial services industry and to its customers that information provided is 'fit for purpose', readily interpreted and is presented objectively. Data is also a key element in ensuring that markets operate effectively.

Currently the Australian Bureau of Statistics (ABS), Reserve Bank of Australia (RBA), Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) all separately collect data, and release information including statistics, on various aspects of the financial services industry.

The existing coverage, quality and depth of the data are, at times, open to question. While the relevant financial services laws, market practice and the industry profile has evolved significantly over the last 10 years, the collection methodologies and analysis adopted by our regulators have changed little<sup>16</sup>. It is IFSA's view that there should be a broad ranging review of data collection for the financial services industry and that a single data collection portal should be established as recommended by the 'Rethinking Regulation' (Red Tape) Taskforce<sup>17</sup>.

IFSA believes that there is an immediate need for improvement in data collection and analysis of the superannuation and managed funds industries. In relation to superannuation, Australian superannuation assets have been estimated to grow to \$3,300 billion by June 2017.

Our superannuation industry has been subject to significant changes, having

been transformed from a defined benefit system where the trustee was prudentially regulated to ensure the promise of defined benefits were met, to a defined contribution system where the return to a beneficiary is dependant on fund performance. Yet, at times, unqualified information released by our regulators generally fails to reflect variables such as different unit pricing methodologies and allocation strategies relevant to the customer<sup>18</sup>. The result can be a misinformed market.

In an increasingly competitive market, comprehensive data coverage is critical to future decision making for legislative design, business and investment decisions. Australia requires a robust superannuation data collection system to inform superannuation investors and their advisers. Individuals investing in superannuation for their retirement have both choice of superannuation fund<sup>19</sup> and investment choice responsibilities<sup>20</sup>. An investor is faced with an array of possible investment strategies and multiple investment asset selections.

The existing data collection arrangements have not, in IFSA's view, met this challenge and should be re-evaluated.

**IFSA recommends** that:

- Government review existing data collection arrangements to more accurately reflect the information needs of Government, investors and their advisers;
- Appropriate data collections be used to produce a robust set of quarterly financial services industry statistics;
- Data collection agencies – APRA, ASIC, AUSTRAC and ABS – liaise with a view to ensuring that:
  - Government, business and consumers have comprehensive industry data available to them;
  - data collection methodologies reflect changes in the market and industry practice.

## 3.5 Industry Structure

IFSA members operate in a highly integrated and competitive industry where funds managers, financial product manufacturers and distributors actively compete for customers. Australian financial services businesses have driven technological developments and operational systems to better meet the needs of their customers. They have met this challenge by delivering cost benefits through the development of a significant degree of horizontal and vertical business integration in addition to boutique operations.

The diversity within our industry is a significant strength and offers investors a wide range of investment choices.

The grouping together of manufacturing activities and services relevant to particular customer segments affords greater clarity and removes service and distribution resource overlaps. The vertical integration of business units were designed to ensure that decisions are made with speed and responsiveness. Vertical integration is a problem only in a poorly contested market where it can result in less competition and market manipulation. This is not the case in the Australian financial services market which is well contested, highly competitive and delivers significant financial and economic benefits to customers.

### 3.5.1 The Problem

IFSA recognizes that some market participants are, at times, less than vigilant in ensuring compliance with the law. For these reasons IFSA supports ASIC's endeavors to raise awareness of conflicts of interest and better outcomes. However, uncertainty in the administration of the law in this area is a big issue that must be addressed.

While the law is clear that conflicts must be managed<sup>21</sup>, the administration of the law in this area is at best opaque. In the absence of a clear statement of principle or purpose,

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IFSA believes that this uncertainty will continue.

Taken to its extreme, avoidance of conflicts would have the effect of undermining existing industry structures and operations. It was never the intention of Government to outlaw conflicts of interest in financial arrangements. The obligation on financial services licensees to manage their conflicts was introduced by the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2003. The Explanatory Memorandum to the Act states:

4.151 The key objective is for financial services licensees and their representatives **to manage conflicts of interest effectively**, including through transparent disclosure of relevant conflicts, so that the market will have confidence in the integrity of the services they provide. **Adequate disclosure of conflicts will assist investors and others in assessing the objectivity of any views provided.**

This facilitates informed investment decision-making and encourages confident participation in financial markets.

Current retail and wholesale structures are, we believe, sound and working well. However, questions have been raised about the integrity of arrangements and practices where the potential for conflicts of interest have been identified. This has the effect of undermining both consumer and business confidence.

### 3.5.2 The solution

The conflicts management and disclosure requirements under the Corporations Act are part of the broader statutory obligations of the financial services licensee. Licensees are required to disclose both costs and benefits in any arrangement providing the customer with a service to ensure that the customer transacts knowing the benefit that will accrue to the provider of the financial product or service.

Regulation should provide, at minimum cost, an appropriate foundation for business to operate effectively. The fact that related parties may combine to provide a range of financial services should not of itself taint the services offered by one of those parties and provided to customers.

The law requires conflicts to be managed. The three mechanisms that licensees would generally use to manage conflicts are to control, disclose or to avoid the conflict<sup>22</sup>. The only circumstance where a conflict must be avoided is where it would result in a contravention of the law.

IFSA believes that while there should not be any change to the substantive requirements of the law, the scope and purpose of the conflicts management obligation imposed should be more clearly spelt out by the development, in conjunction with industry, of Conflicts of Interests Principles.

**IFSA recommends** that:

- The principles based approach to conflicts of interest should be maintained.
- The financial services industry participants work with the regulators to develop a clear set of Conflicts Principles.

## 3.6 Regulator Accountability

IFSA supports the twin regulatory peaks separating prudential regulation by APRA from market regulation and consumer protection by ASIC. There is, in our view, a logical division in the current regulatory arrangements.

Essential to effective financial sector regulation is regulator governance structures and accountability to Government and the community. In this regard, IFSA believes that the financial services industry would benefit from enhanced oversight arrangements for financial sector regulatory bodies.

While the Reserve Bank has a Board of Governors<sup>23</sup>, ASIC, APRA, and AUSTRAC are accountable to the Parliament only through their Minister and Senate Estimates Committee Hearings. We note that the Council of Financial Regulators, which first met in May 1998, acts as a forum for the respective financial service regulators and the Treasury to coordinate their role and advice to Government. However, it does not perform an oversight role in relation to the operations of the respective regulators. The Council operates primarily as an informal forum for consideration, discussion and agreement on regulatory issues where responsibilities overlap. The Council is non-statutory and has no regulatory functions separate from those of its members.

Enhanced oversight could be implemented either by adopting the Reserve Bank model<sup>24</sup> or expanding the functions of a body such as Financial Sector Advisory Council<sup>25</sup> (FSAC) to include operational oversight of ASIC, APRA and AUSTRAC. We note that the Treasurer, the Hon Wayne Swan MP, has strengthened the Board of FSAC<sup>26</sup> and we consider that there is an opportunity to broaden its charter to provide an oversight role.

A Board of Governors or FSAC oversight would assist in prioritising the agenda of the regulatory agencies, monitor and assess regulator performance, and review program delivery/implementation. Our regulators should not be exempt from the high standards of governance demanded by Government. We believe that this could be addressed through the introduction of enhanced oversight arrangements.

**IFSA recommends** that enhanced oversight arrangements be established to oversee the operations of each of ASIC, APRA, and AUSTRAC.

## 3.7 Industry Standards

The number of financial institutions, the increasing complexity of their businesses and

the continuing impact of globalisation mean that regulators have little choice other than to rely on institutions self assessing themselves against regulatory requirements.

The Australian regulatory landscape, post the 1997 Financial System Inquiry Report, represented a shift to greater self-regulation within a framework oversighted by the regulator<sup>27</sup>. A significant degree of self regulation occurs within the financial services industry as a result of structural reforms, the internalisation of legal compliance obligations and external reporting mechanisms, and good business practice.

### 3.7.1 IFSA's role in industry self regulation

As stated in the 2006 IFSA Regulatory Headland Statement, IFSA has had in place an Industry Code of Ethics and Conduct supported by a number of industry standards and guidelines that are designed to assist members achieve industry best practice, and to enhance consumer confidence. The financial services industry has been subject to standards set by industry participants through their association in organisations such as IFSA since 1991<sup>28</sup>.

Rigorous industry codes and standards are, in IFSA's view, an important component of the overall regime applying to industry regulation. Reliance on codes and standards can build public trust and consumer confidence in the industry as well as exerting moral and business pressures on those sections of the industry that may otherwise be tempted to behave in an unprofessional way.

IFSA is currently reviewing its Guidance Notes on calculators<sup>29</sup> and mortgage trust disclosure<sup>30</sup> with a view to turning those Guidance Notes into mandatory IFSA Standards.

### 3.7.2 Compliance with IFSA Standards

IFSA members are required, as a condition of membership, to comply with IFSA Standards. The boards of IFSA member companies must complete and sign an annual statement of compliance with the Standards. Members may seek exemption from the requirements of particular standards which are considered by the IFSA Standards Oversight and Disciplinary Committee (SODC).

The charter of the SODC was approved by the IFSA Board on 14 February 2007. The Committee is a sub-committee of the IFSA Board and comprises three IFSA Directors. The mandate of the SODC is to oversee member adherence with the principles set out in IFSA Standard No.1 – Code of Ethics. Its functions include the consideration of proposals for the development, revision or amendment of IFSA Standards; approve new Standards or revisions to existing standards; hear and assess complaints against IFSA member companies, expediting disciplinary action if required; hear and assess issues of non-compliance with IFSA Standards; and, oversee the annual compliance process and provide a report for publication.

The requirement for all IFSA members to conform to rigorous industry standards will support the use of principle based legislation by Government, and will promote market confidence and adherence to the principles of the legislation.

### 3.7.3 Next Steps

The IFSA membership is involved in the management or administration of approximately 95% of the managed investments industry assets. IFSA will continue to issue mandatory Standards and best practice Guidance Notes to assist members to address their legal compliance and operational obligations under the law.

IFSA has taken a leading role in advancing best practice regulation for the managed investments industry in Australia through its Standards and Guidance Notes. Good regulatory outcomes, whether legislated or self regulatory, depend on effective communication between Government, the industry and consumers.

IFSA will continue to support effective liaison with Government, regulators and other stakeholder parties to address industry issues. IFSA has established a structure to support compliance with IFSA Standards and, in the interests of best practice and principles based regulation, IFSA will consider how it could strengthen its role in setting standards for the financial services industry.

IFSA proposes to continue to play a leading role in setting standards for the financial services industry.

## 4. Conclusion

Australian financial services businesses operate within a regulatory system that is striving to enhance business efficiency and provide appropriate protection for consumers. IFSA believes that the efficiency of our regulatory system will be significantly enhanced by the adoption of the recommendations made in this Regulatory Headland Statement, and the IFSA 2006 Regulatory Headland Statement, to the extent that the recommendations have not been adopted.

In many respects Australia has a model regulatory system, but we must not grow complacent.

Australian businesses operate in a global economy and to continue to effectively compete, we must strategically review and evaluate our laws. The IFSA recommendations to Government provide a platform for reform and encouragement to continuously review the operation and effectiveness of our regulatory system.

## 5. Recommendations & Proposals

### 5.1 Benchmarking Australian Regulation

**IFSA recommends** that tax reform initiatives continue to feature as a priority in a co-ordinated response to both domestic and global challenges to Australian competitiveness.

### 5.2 Operational Efficiency

**IFSA recommends that:**

- The Corporations Act expressly provide that all regulated documents may be provided to customers by electronic means. Paper based documents would be provided on request of the customer;
- Practical barriers to the use of incorporation by reference be identified and addressed, and that industry work with Government to establish a regime that permits more effective disclosure to investors;
- Mandated disclosure required by Schedule 10 of the Corporations Regulations should be reviewed to ensure that such disclosures are effective and not misleading.
- legislation implementing a regime that facilitates financial product rationalisation be introduced into the Parliament in 2008;
- the takeover threshold requirements of the Corporations Act be reviewed and that the takeover requirements be amended to enable the disaggregation of associate interests where the acquisition and holding of the interests are held in a fiduciary capacity for a public offer managed investment scheme; and
- the application of duplicative requirements under the AML/CTF

law be avoided and to the extent possible that the law continue to have a risk based focus and that those requirements be principles based.

### 5.3 Financial projections

**IFSA recommends** that Government initiate a review to examine the need for legislative reform to provide a framework for the provision of member benefit projections in superannuation.

### 5.4 Industry Data

**IFSA recommends that:**

- Government review existing data collection arrangements to more accurately reflect the information needs of Government, investors and their advisers;
- Appropriate data collections be used to produce a robust set of quarterly financial services industry statistics;
- the Data collection agencies – APRA, ASIC, AUSTRAC and ABS – liaise with a view to ensuring that:
  - Government, business and consumers have comprehensive industry data available to them;
  - data collection methodologies reflect changes in the market and industry practice.

### 5.5 Industry Structure

**IFSA recommends that:**

- The principles based approach to conflicts of interest should be maintained.
- Financial services industry participants

work with the regulators to develop a clear set of Conflicts Principles.

### 5.6 Regulator Accountability

**IFSA recommends** that enhanced oversight arrangements be established to oversee the activities of ASIC, APRA, and AUSTRAC.

### 5.7 Industry Standards

IFSA proposes to continue to play a leading role in setting standards for the financial services industry

## Footnotes

- 1 Regulatory Affairs Board Committee, Economic Savings and Tax Board Committee, Marketing and Distribution Board Committee, Investment Board Committee, Life and Risk Management Board Committee, Operations and Technology Board Committee, Global Markets Board Committee, Financial Advisory Network Board Committee, and Standards and Oversight Disciplinary Committee.
- 2 IFSA – Towards Better Regulation, Policy on future regulation of Financial Services in Australia, (February 2006) at [www.ifsa.com.au/documents/2006\\_Publications\\_Regulation.pdf](http://www.ifsa.com.au/documents/2006_Publications_Regulation.pdf)
- 3 Superannuation Advisory Committee; Financial Services Working Group Advisory Panel; Product Rationalisation Advisory Panel.
- 4 The Treasurer announced on 30 May 1996 the establishment of an Inquiry that was directed to provide a stock take of the results arising from the financial deregulation of the Australian financial system since the early 1980s. The Inquiry presented its report to the Treasurer in March 1997.
- 5 See report of statement by Dr Richard Jackson, Program Director and Senior Fellow at the US-based Centre for Strategic and International Studies, at a Metlife Media Symposium in New York in June 2008.
6. See Chapter 3 'Engaging with the Global Economy' of the 2007 ALP National Platform and Constitution
- 7 Media Release, The Hon. Chris Bowen MP, Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, Board of Taxation to Review Tax Arrangements Applying to Managed Funds , 22 February 2008..
- 8 The Tax Laws Amendment (Election Commitments No 1) Bill 2008 the Income Tax (Managed Investment Trust Withholding Tax) Bill 2008 and the Income Tax (Managed Investment Trust Transitional) Bill 2008 were introduced into Parliament on 4 June 2008.
- 9 We note the release of ASIC Consultation Paper CP93 which aims to facilitate online delivery of financial disclosure.
- 10 Research conducted by Investment Trends for IFSA. Report released in September 2007.
- 11 See IFSA Media Release, 8 May 2008, Investors plea: "Spare us from long, dull PDSs". The research was undertaken by the Wallis Consulting Group and its "Report of Findings of Qualitative Research into Effective Disclosure (Stage II)" was released on 8 May 2008
- 12 What must be included:
  - significant features and characteristics, rights, terms, conditions and obligations;
  - explanation of adviser remuneration and worked examples;
  - a summary description of the key risks of the product;
  - a statement setting out the name and contact details of the issuer of the product and, if the statement is a sale statement, the seller;
  - the fee disclosure regulation requirements, apart from the additional explanation section;
- information about the dispute resolution system that covers complaints by holders of the product and how that system may be accessed; and
- information about any cooling-off regime that applies in respect of acquisitions of the product.
- 13 The new designated services under tranche 2, described as "professional services", potentially capture the activities of financial advisers, many of which are already captured under tranche 1.
- 14 Association of British Insurers, Mortgage Endowments – A Factsheet, September 2006
- 15 Australian Bureau of Statistics, 56550.0 – Managed Funds, Australia, March 2008
- 16 For example, up to the mid 1990s, the superannuation industry was populated predominantly by defined benefit schemes. There was clear industry segmentation and now the industry has a majority of defined contribution superannuation schemes where fund members can not only exercise superannuation fund choice but also investment choice.
- 17 Australian Government, 'Rethinking Regulation: Report of the Taskforce on Reducing the Regulatory Burdens', January 2006, Chapter 5 – Economic and Financial; Regulation pp 95-100 at [http://www.regulationtaskforce.gov.au/finalreport/regulation\\_taskforce.pdf](http://www.regulationtaskforce.gov.au/finalreport/regulation_taskforce.pdf)
- 18 See APRA Media Release of 28 March 2008.
- 19 Superannuation Legislation Amendment (Choice of Funds) Act 2004
- 20 APRA Superannuation Circular No.II.D.1 Managing Investments and Investment Choice (March 2006)
- 21 Section 912A(1)(aa) of the Corporations Act 2001
- 22 See ASIC RG 181.20
- 23 The Reserve Bank Board comprises nine members: three ex officio members – the Governor (who is Chairman), the Deputy Governor (who is Deputy Chairman) and the Secretary to the Treasury – and six external members, who are appointed by the Treasurer.
- 24 The role, responsibilities and composition of the Reserve Bank Board are laid down in the Reserve Bank Act 1959.
- 25 The Council is a non-statutory body established in March 1998. It brings together a range of financial market participants to provide advice to the Government on policies to facilitate the growth of a strong and competitive financial sector. Members are appointed for two years in a personal capacity subject to their continued direct involvement in the financial sector.
- 26 Treasurer of the Commonwealth of Australia's Press Release No.020, Appointments to the Financial Sector Advisory Council.
- 27 'Institutional self-regulation: what should be the role of the regulator', speech by Jillian Segal, Deputy Chair of the Australian Securities and Investments Commission, to the National Institute for Governance Twilight Seminar, Canberra, 8 November 2001
- 28 The current IFSA Standards are:
  - No1: Code of Ethics and Conduct
  - No2: Equity Trusts
  - No5: Operational Capability
  - No6: Fund Performance, calculation of returns
  - No7: Use of IFSA logo
  - No8: Scheme Pricing
  - No9: Valuation of Scheme assets & liabilities
  - No10: Promotional Statements
  - No11: Genetic Testing Policy
  - No13: Proxy Voting
  - No14: Alternative forms of remuneration
  - No15: Rebates & related payments
  - No 16: Family Medical History Policy
  - No.17: Incorrect pricing of Scheme Units – Correction and Compensation
- 29 Guidance Note 21: Calculators – Best Practice Guidelines
- 30 Guidance Note 6: Mortgage Trust Disclosure

## Full members

Aberdeen Asset Management Limited  
Adelaide Managed Funds Limited  
Allco Funds Management Limited  
AllianceBernstein Australia Limited  
Allianz Group  
American International Assurance Co. (Aust) Ltd  
AMP  
Atom Funds Management Pty Ltd  
Australian Ethical Investment Ltd  
Australian Market Quotation (Ausmaq) System Ltd  
Australian Securities Limited  
Australian Unity Funds Management  
Australian Wealth Management Limited  
Aviva Australia Limited  
AXA Australia  
Banksia Financial Group  
Barclays Global Investors Australia  
Blackrock Investment Management (Australia) Limited  
BNP Paribas  
BT Financial Group  
Centro Properties Group  
Challenger Managed Investments Limited  
City Pacific Limited  
Clearview Retirement Solutions  
Colonial First State Investments Limited  
Columbus Investment Services Limited  
Credit Agricole Asset Management  
Credit Suisse Asset Management (Australia) Limited  
CVC Managers Pty Ltd  
Deutsche Asset Management (Australia) Limited  
Equity Trustees Limited  
Fidelity Investments Australia Limited  
Franklin Templeton Investments Australia Limited  
Galileo Group  
General Reinsurance Life Australia Ltd  
GE Money  
Goldman Sachs JBWere Asset Management  
Guild Financial Services Limited  
Hannover Life Re of Australasia Ltd  
Hunter Hall Investment Management Limited  
IAG Asset Management Limited  
ING Australia Limited  
Ingevity Pty Ltd  
International Underwriting Services Pty Ltd  
INVESCO Asset Management Australia Limited  
IOOF Investment Management Ltd  
Janus Capital Asia Limited  
La Trobe Financial Services Pty Limited  
Legg Mason Asset Management Australia Limited  
Lifeplan Funds Management  
Macquarie Investment Management Limited  
Magellan Asset Management Limited  
Maple-Brown Abbott Limited  
Mariner Financial Limited  
Mercer  
Mellon Global Investments Australia Limited  
Metlife Insurance Limited  
Mirvac Funds Management  
MLC Limited  
Morgan Stanley Investment Management  
Munich Reinsurance Company of Australasia Limited  
Naos Asset Management Limited  
NavralInvest Limited  
Netwealth Investments Limited  
New South Wales Treasury Corporation  
Ord Minnett  
Perpetual Investment Management Limited  
Plan B Trustees Limited  
Portfolio Partners Limited  
Prime Value Asset Management Limited  
Principal Global Investors (Australia) Ltd  
Professional Investment Services Group  
Putnam Investments Australia Pty Limited  
QBE Management Services Limited  
QFV Investment Management Limited  
Q Invest Limited  
Queensland Investment Corporation  
RGA Reinsurance Company of Australia Limited  
Rural Funds Management Ltd  
Russell Investment Group  
Sandhurst Trustees  
Schroder Investment Management Australia Limited  
Select Asset Management Limited  
Skandia Limited  
St George Group  
St George Life Limited  
Standard Life Investments (Asia) Limited  
State Street Global Advisors Australia  
State Super Financial Services Limited  
State Trustees Ltd  
Suncorp-Metway Limited  
Sunsuper Pty Ltd  
Swiss Re Life & Health Australia Limited  
TOWER Australia Limited  
Trust Company of Australia Limited  
Uniting Growth Fund Limited  
UBS Global Asset Management (Australia) Ltd  
Vanguard Investments Australia Limited  
Wellington International Management Company Pty Ltd  
Westfield Management Limited  
Zurich Australia Limited

## Supporting members

Allens Arthur Robinson  
APIR Systems Limited  
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AXISS Australia  
Baker & McKenzie  
Blake Dawson Waldron  
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ComSuper  
Computershare Limited  
Corrs Chambers Westgarth  
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Ernst & Young  
Financial Essentials  
Freehills  
Gilbert & Tobin  
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InfoComp Pty Limited  
InvestmentLink Pty Limited  
JPMorgan  
Kemp Strang  
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Maddocks, Lawyers  
Mallesons Stephen Jaques  
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Money Solutions Pty Limited  
Morningstar Pty Ltd  
Morse Consulting Pty Limited  
NAB Custodian Services  
Omgeo Pty Ltd  
PricewaterhouseCoopers  
RBC Dexia Investor Services  
Rice Warner Actuaries  
Standard & Poor's Information Services (Aust) Pty Ltd  
Victorian Funds Management  
van Eyk Research Limited

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