Stockbrokers
Association of Australia
Incorporating SDIA

31 March, 2015

Senior Manager,
Financial System and Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: fsi@treasury.gov.au

Dear Sir/Madam

FINAL REPORT OF THE FINANCIAL SYSTEM INQUIRY (FSI)
SUBMISSION BY STOCKBROKERS ASSOCIATION OF AUSTRALIA

The Stockbrokers Association of Australia Limited ("the Stockbrokers Association") appreciates the opportunity to provide these comments to Treasury in respect of the Final Report of the Financial System Inquiry ("FSI") released on 7 December 2014 ("the Final Report").

GENERAL COMMENTS

The Stockbrokers Association commends the FSI for its thorough examination of the many key issues explored in the course of the FSI, and for the quality of the Final Report.

In our view, it was timely for the Government to commission the FSI in order to strengthen and enhance Australia's financial system into the future. The Stockbrokers Association has been supportive of the Inquiry and has made Submissions at various stages, including in relation to the Interim Report.

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Many of the recommendations in the Final Report are financial system-wide issues which, whilst potentially having an indirect effect on the stockbroking industry (as well as others), do not directly focus on our sector. The Stockbroking Association does not make any comment about those recommendations, nor do we comment on issues that are directly targeted at specific areas of the financial sector that do not relate to stockbroking. Rather, the Association limits its submissions below to the specific Recommendations in the FSI Final Report and other references that have a direct impact on the stockbroking industry.

Our submissions adopt the numbering, Chapter and page references from the FSI Final Report for ease of cross reference.

CHAPTER 3: INNOVATION (PAGES 143–192)

Recommendation 15 – Digital identity

Develop a national strategy for a federated-style model of trusted digital identities.

The Stockbrokers Association supports a strategy of digital identity verification to assist in reducing the significant costs and duplication involved in complying with the raft of legislative requirements, both locally and overseas, which require the establishment of a person's identity. This includes requirements under Anti-Money Laundering and Counter Terrorist Financing legislation and the growing number of Tax avoidance regimes world-wide, such as FATCA and the G20 Common Reporting Standards.

At present, vast amounts of financial and human resources are devoted on a continuous basis worldwide in carrying out customer identification (KYC) processes. Every time a person or entity seeks to do business or seeks a financial service, or many other services, they will most likely have to undergo KYC procedures. This process might therefore be duplicated many times over as the customer is in turn identified by each service provider with whom they seek to do business, all of which will ask for the same documents, carry out the same or similar searches, identification and verification procedures, and so on.

Whilst the policy objectives underlying efforts to prevent Money Laundering and Tax avoidance are undeniable, the level of duplication that is currently taking place is a major resource cost. To the extent that a trusted form of identification can be established that is capable of being relied on by industry, this could potentially deliver a significant saving in cost and time.

In order to maximize efficiencies in this area, it would be helpful if this initiative were to be co-ordinated globally. It would be counterproductive if different jurisdictions were to pursue independent competing schemes for identity verification, as different regimes that were not consistent might end up eroding the process efficiencies that the schemes were designed to deliver in the first place.

Recommendation 18 – Crowd Funding

Graduate fundraising regulation to facilitate crowdfunding for both debt and equity and, over time, other forms of financing.

The Stockbrokers Association cautiously accepts that the rise in new technological innovations and social media avenues will generate a community acceptance for new facilities for debt and equity funding that take advantage of new technology.

It is difficult to comment more fully on these new avenues without seeing more detail about how they are proposed to operate.

As a preliminary point, to the extent that these new forms of funding can provide access to funds for entities that currently have difficulty in securing either debt funding from traditional sources of lending, or equity capital through traditional means, then there may be a current gap in the market that crowdfunding could potentially satisfy. This is not to say however that there is a problem with the existing equity capital markets do not work, which there is not, or that retail investors do not have access to IPO investment opportunities at all levels of the market, which they clearly do.

The overriding concern that the Stockbrokers Association has is that there must be no erosion of investor protection or damage to the high standing and integrity of Australia's capital markets. This high standing translates into enormous advantages for the Australian market and the Australian economy. It was this reputation for integrity and Australia's regulatory settings which enabled Australia to recapitalize during the Global Financial Crisis to a level that was not possible in other countries. This was highly instrumental in Australia weathering the worst of the GFC in better shape than virtually every other country.

The Stockbrokers Association recognizes that new technology cannot be ignored, however on the other hand, Australia should not rush to embrace new platforms simply because other jurisdictions are doing so, without a thorough evaluation of the risks presented and adequate opportunity to design the right level of regulation to safeguard the interests of investors and of the markets.

There should be appropriate prudent limits applied to the amounts that can be raised using these new avenues, and the amounts that can be invested by individuals, in order to limit the potential risks. Any arrangements should be closely monitored throughout a full investment cycle, for instance, to see how they operate in a downturn as well as a positive part of the cycle.

CHAPTER 4: CONSUMER OUTCOMES (PAGES 193–232)

Recommendation 21 – Strengthen Product issuer and distributor accountability

Introduce a targeted and principles-based product design and distribution obligation.

Stockbrokers Association members are supportive of aligning the interests of consumers with product issuers. However, reservations have been expressed about what such a design and distribution would entail, and would need more information in order to be in a position to comment fully. There are concerns that the terms of such an obligation could adversely impact on the design and innovation of new products.

Concerns have also been expressed about the extent to which those new processes would create additional costs for the product development process, which added costs would need to be passed on to the consumers of those products i.e. investors.

Recommendation 22 – Introduce Product Intervention Power

Introduce a proactive product intervention power that would enhance the regulatory toolkit available where there is risk of significant consumer detriment.

The FSI Report recommends giving ASIC a broad product intervention power, that would enable it to intervene and impose obligations relating to marketing; warnings to consumers; imposing restrictions on distribution; and banning a product.

The Association strongly supports investor protection, and in our previous Submission to the FSI interim report, the Association acknowledged that the experience in recent years with a number of financial products that were unsuitable for retail investors were sufficient to justify a recommendation that ASIC be afforded a broad product intervention power.

The Association's residual concern is to ensure that such a power be used appropriately.

Such a power would have an outcome not unlike injunctive relief that might otherwise only be obtainable from a Court, and could amount to a significant impact on the affairs of a financial product provider. In particular, the types of powers ASIC is seeking could result in a financial product provider being required to incur substantial cost through advertising, publication, and suspension of business.

ASIC should be required to issue a Policy Document setting out the circumstances in which it would consider using such a power, the alternatives that might be considered or exhausted before the power was used, and so on. It may be that in appropriate cases, such a power may need to be used expeditiously in order to protect the public, but this might not always be the case. Powers as wide as are being mooted must not be used capriciously or in a way that leads to uncertainty.

There should also be an appropriate mechanism for oversight of ASIC's use of such an intervention power.

Recommendation 23 – Facilitate Innovative Disclosure

Remove regulatory impediments to innovative product disclosure and communication with consumers, and improve the way risk and fees are communicated to consumers.

The extent to which society has rapidly embraced electronic communication has been dramatic. It no longer makes sense not to make full use of the potential for new and innovative ways of communicating product disclosure and other significant information to consumers.

ASIC has already adopted some important changes to facilitate online financial services disclosure and electronic delivery of significant documentation to investors. The Stockbrokers Association supports further review of remaining regulation to take this further. The one proviso is that there must remain an option for individuals to elect to request a non-electronic form of communication if electronic communications are not possible or not appropriate to them (for example, due to age or lack of computer literacy).

Given the increasing tendency of people to avoid digesting written material, the Stockbrokers Association also supports the use of new technology to deliver disclosure in an innovative way. The policy underlying the regime of prospectus disclosure is a strong one, although the outcome in many cases of lengthy printed documentation does not always deliver on the policy objective.

The Association does not support the watering down of the obligations to make adequate disclosure, including in Product Disclosure Statements, Prospectuses and Takeover documentation. However, to the extent that innovative electronic media can be utilized to provide an enhanced interpretative experience for the recipient of a prospectus or a product disclosure document, the Association would consider this to be an improvement. Regulatory impediments to using such avenues should be removed, provided that appropriate user testing of the new forms of communication is carried out to ensure that it achieves its objectives.

A significant rider to the Association's support for this proposal is that it be directed to reducing business costs, and not be implemented in a way that adds to costs.

Recommendation 24 – Align the interests of Financial Firms and Consumers

Better align the interests of financial firms with those of consumers by raising industry standards, enhancing the power to ban individuals from management and ensuring remuneration structures in life insurance and stockbroking do not affect the quality of financial advice.

The Stockbrokers Association considers that the alignment of the interests of financial firms and consumers to be axiomatic.

To the extent that those interests can be even better aligned than at present, the Association supports such improvements, provided they make sense.

The Stockbrokers Association has long supported the raising of industry standards. The Association maintains a Code of Conduct to which all members are required to adhere. The Association has for some time offered its members a Professional Certification, ongoing Professional Education and Continuing Professional Development programs.

We will comment more fully in relation to education standards under Recommendation 25 below.

The Stockbrokers Association takes issue with that part of Recommendation 24 "*……ensuring remuneration structures in life insurance and stockbroking do not affect the quality of financial advice".* The FSI Report also states that "specific attention is required in the stockbroking sector in the immediate future", and that ASIC should review current remuneration practices in the stockbroking sector.

The Stockbrokers Association takes issue with these aspects of Recommendation 24. The remuneration structures common in stockbroking have undergone microscopic scrutiny, particularly during the recent introduction of the conflicted remuneration provisions of FOFA. They have been found by ASIC and by Treasury not to represent conflicted remuneration nor to present a risk to clients, and on this basis, the stockbroking industry was granted FOFA carve-outs from the conflicted remuneration provisions.

The FSI Final Report also states that ASIC has identified compliance issues in the stockbroking industry, although the Report cites as its two examples of this, two well-publicised cases of enforceable undertakings arising from the wealth management /financial planning businesses of two firms. These cases did not, as far as we were aware, relate to stockbroking. ASIC has certainly not advised the Stockbrokers Association that it has identified compliance issues in the stockbroking industry.

Further to this, the figures from the Financial Ombudsman Service regarding stockbroker complaints in recent years do not support this conclusion. For the 2014 Financial Year, complaints against stockbrokers fell 17% to 42, only 8 of which relation to advice. The number of complaints over the past 5 years has more than halved, in respect of total stock market transactions numbering in millions.

Hence the Association was somewhat surprised to see these comments in connection with Recommendation 24 in the FSI Final Report.

A remuneration structure based on salary and commission sharing is well understood, is product neutral, and is subject to a regime of supervisory controls in the Corporations Act and market Integrity Rules which deal with any risk of churning. Broker commissions are product neutral in that there is not different brokerage charged if a client trades, say, BHP rather than RIO. The brokerage is charged as a percentage of the trade value, regardless of which product is traded. Hence, there is no risk that advice to a client will be conflicted, and that clients will be steered towards one stock rather than other because of the level of commission.

Clients understand how brokerage commission is charged, and therefore, it is hard to see how the present remuneration structures present a regulatory risk or affects the quality of financial advice.

In our submission, Recommendation 24 as far as it deals with stockbroker remuneration is not supported by evidence. The Stockbrokers Association does not fear the outcome of a review as proposed, but in our view, a review is not needed, and the Government should not adopt this aspect of the Recommendation.

Recommendation 25 – Raise the Competency of Financial Advisers

Raise the competency of financial advice providers and introduce an enhanced register of advisers.

As mentioned above in relation to Recommendation 24, the Stockbrokers Association is supportive of the current proposals to raise standards for financial advisers and to introduce a Register of Advisers (which comes into effect on 31 March 2015). The proposals have been put forward in a variety of different concurrent reviews that have been undertaken in recent times, not just the FSI. The Stockbrokers Association has participated in each of those reviews.

The Association has not been a supporter of the ASIC proposal for a National Exam for financial advisers. In our view, a "one size fits all" single exam for all financial advisers would not raise standards. Rather, it would need to be so generic as to be a waste of time and money, in the Association's view.

We note that the FSI Final Report also contains a note to the effect that the FSI does not support a national exam (see page 225). We submit that the Government should endorse this view and not adopt the ASIC National exam proposal.

Whilst the Stockbrokers Association supports the move towards minimum university degree qualifications for advisers, we are very concerned about the lack of recognition of industry experience and prior learning. There needs to be appropriate "grandfathering" to enable experienced advisers to remain in the industry and not be forced to leave the industry prematurely. In our view, clients of a broker with industry experience and who are happy with the service they are getting are more than likely to want the choice whether to stay with that broker, and may not prefer an adviser who hold a university a degree who is not long out of university. Clients should have some choice in the matter.

Lack of adequate grandfathering also runs counter to policies on valuing older workers, and on encouraging people to remain gainfully employed in their senior years if they so wish.

CHAPTER 5: REGULATORY SYSTEM (PAGES 233–260)

No Extension of Market Integrity Rules to Shadow Brokers

The Stockbrokers Association is disappointed that the FSI Final Report has declined to recommend any change to regulation by way of extending ASIC Market Integrity Rules (**MIRs**) to persons not currently subject to them, but who offer similar services as those offered by market participants, such as securities dealers.

The Stockbrokers Association has long argued that there is not a level playing field in relation to the regulatory landscape applying to securities advice on listed products.

Over about the last 10-15 years, a situation of regulatory arbitrage has arisen. Standards of supervision by ASX and - since the handover of market supervision in 2010 - ASIC, have increased considerably. Under the MIRs market participants can be fined up to $1m for breaches of the rules. The accompanying costs to market participants in enhanced supervision, compliance and monitoring policies, procedures and systems have also risen considerably.

As well as these internal costs, market participants also pay ASIC around $15m per annum in market supervision fees. No other sector pays these fees. (See below at Recommendation 29 for further discussion of ASIC cost recovery.)

In this environment, there is a substantial inducement to leave the stockbroking area and operate in the less well regulated area of securities dealers.

Many recent product and service failures have come about despite many in the industry identifying them as risks, and avoiding them accordingly. The timber plantation schemes of the last 10-15 years are a good example of this. In a similar way, the failure to properly regulate those dealing and advising in listed product is an area of future risk. The Stockbrokers Association submits that the Inquiry's failure to recommend extending the MIRs to this this sector represents a major failing in its Report.

Recommendation 27 – Regulator Accountability

Create a new Financial Regulator Assessment Board to advise Government annually on how financial regulators have implemented their mandates.

The Stockbrokers Association understands why there are calls for greater scrutiny of financial regulators to ensure that their performance against their objectives is satisfactory. The Association however is not entirely convinced of the reasons why establishing yet another layer of bureaucracy would achieve a better outcome that the current method of accountability to Parliament.

In our view, the existing level of scrutiny by Parliamentary Committee has been very successful in calling regulators to account, whether it be ASIC, RBA, ACCC or whichever. It would be necessary to demonstrate why a "regulator of regulators" (which no doubt in due course would be paid for by industry as well through cost recovery) would achieve a better and lower cost outcome of holding regulators to account than happens at present.

Provide clearer guidance to regulators in Statements of Expectation and increase the use of performance indicators for regulator performance.

The Stockbrokers Association queries whether there is any significant lack of clarity of the role of Australia's financial regulators. The Association is not opposed in principle to the greater use of Statements of Expectations and Performance indicators in relation to regulators. However we query whether recent cases where issues have arisen in relation to the performance of financial regulators has been the result of regulators not fully understanding their mandate, as opposed to simply failing to perform their functions adequately.

Recommendation 28 – Execution of Mandate

Provide regulators with more stable funding by adopting a three-year funding model based on periodic funding reviews, increase their capacity to pay competitive remuneration, boost flexibility in respect of staffing and funding, and require them to undertake periodic capability reviews.

Recommendation 29 – Strengthening the Australian Securities & Investments Commission's funding and powers

Introduce an industry funding model for the Australian Securities and Investments Commission (ASIC) and provide ASIC with stronger regulatory tools.

The above two Recommendations are interrelated and best commented on together.

The Stockbrokers Association appreciates the arguments in favour of ensuring that ASIC is funded by a model that is more stable and also is more capable of giving it the level of resources which it needs to do its job. The agency needs to be less susceptible to the vagaries of acute budget pressures at the Government level, and the potential for critical programs to suffer when Government funds are tight is not good for our markets.

However, there are a number of key aspects of the funding arrangements that must be carefully thought out. There are some serious flaws in the existing model for funding of ASIC's Market Supervision budget that are creating serious detriment. These flaws need to be remedied, and should not be reproduced in any model that applies to the ASIC budget generally. We discuss these flaws as follows:

1. Lack of a framework to supervise ASIC spending and cost control

Any move towards placing ASIC on a full autonomous funding model should not occur without the introduction of adequate supervision over the level of spending, and the ability of the industries who will bear the cost of funding those agencies having some say on the amounts they are being called upon to pay.

The ASIC Cost Recovery arrangements have highlighted the lack of transparency over project spending, and the inability of market participants to have any real input on that spending. ASIC has recently recovered approximately $42 million from industry, predominantly from the stockbroking industry, to pay for an enhanced electronic market surveillance system. This amount has subsequently been revised down and an amount of $5 million returned back to industry due to the project coming in under budget.

Whilst the industry did not take issue with ASIC's need for a new system, market participants did not have any understanding why the cost of the system needed to be so high. Participants have considerable understanding of the costs of developing electronic trading software, being an essential part of the business of many of them, and could not see why a surveillance system should have cost as much as was budgeted. However, there was no mechanism or ability to have any input into the process.

There is an inherent lack of fairness in being asked to pay for a budget over which one has no control. If ASIC were to move to an autonomous fully cost recovered model, there would need to be some means of close supervision to ensure that industry could have confidence that prudent discipline and cost control was being applied by those agencies in setting their budgets.

The Association's concerns about spending are exacerbated by the other aspects of Recommendation 28, namely, that ASIC be released from public sector constraints on pay and recruitment. Whilst it makes sense that ASIC be in a position to offer more attractive remuneration in order to obtain the necessary skills for it to do its job, this could lead to the potential for a significant blow out in ASIC's budget on an ongoing basis. It is not satisfactory to then place the onus on industry to bear the burden of paying for that budget without some mechanism for input to be satisfied that prudent cost control measures are being followed.

2. Poor Application of Commonwealth Cost Recovery Guidelines to date

As mentioned, the stockbroking industry has already been the subject of cost recovery arrangements in relation to the ASIC Market Supervision budget.

Under the model employed, the stockbroking industry bears the financial burden of the overwhelming proportion of the ASIC Market Supervision cost recovery levy (some 78% of the total amount).

We note that the FSI Interim Report referred at page 3-110 to the core principles underlying cost recovery, including:-

> *'Total funding should be proportionate to the size, complexity and nature of the regulated population.'*

This in our view has clearly not been the experience of the stockbroking industry in relation to the ASIC Cost recovery model. No amount of representations to Treasury, to ASIC and to the Department of Finance and Deregulation, have had any influence in causing any reconsideration of this model.

Included in these representations have been submissions that the cost recovery liability be shared more evenly with other sectors directly involved in this area of ASIC's function, including fund managers, listed entities and securities dealers. This has not eventuated.

Therefore, the Stockbrokers Association has grave reservations as to the extent to which the principle of proportionality will be applied to ASIC funding arrangements. The Association would be most concerned as to the impact of a disproportionate sharing of the cost recovery burden if ASIC and/or APRA were to move to a full cost recovery model.

3. Lack of holistic approach to cost recovery

With the potential move to put ASIC on to a full cost recovery basis, there is the potential that stockbrokers will become liable for additional ASIC cost recovery at different points of interaction with ASIC. This will be on top of the ASIC Cost recovery levy, which the stockbroking industry already largely pays for, as set out above.

On top of ASIC cost recovery, stockbroking is subject to multiple other cost recovery regimes with other agencies. Stockbrokers are liable for the AUSTRAC cost recovery levy to fund that agency's anti- money laundering supervisory function, shortly to extend to recovery of all of AUSTRAC's budget. In addition, members that are part of a group that is APRA–regulated may already also bear a share of their group's APRA cost recovery arrangements.

Careful thought needs to be given to the financial impact that further cost recovery, should ASIC (and also APRA) move to full autonomous cost recovery of their entire budget, on the financial sector. Loading cost after cost to the industry is creating an impossible cost burden, and undermining its ability to survive and to deliver low cost services and advice to the investing public. It is also undermining the ability of the financial sector to compete in the region. It is jeopardising job creation in the financial sector, which has been identified as a key source of creation of high quality jobs for Australians to replace job losses in other industries that are disappearing).

The consideration of funding ASIC should not be considered in isolation. There needs to be a holistic picture of the cumulative burden of cost recovery already in place in relation to the financial sector, particularly the stockbroking industry, and the distortive or weakening impact that may flow from continued application of cost recovery to that industry or group.

4. Conflict with other key Government Objectives

Careful thought needs to be given as to the extent to which adding further costs onto industry, if funding of ASIC's entire budget is to be cost recovered, will undermine key Government policy objectives that have been elsewhere identified and being pursued.

These include:

(a) Fostering Australia as a regional financial centre. It has been a key objective of this Government to foster Australia's growth as a regional financial centre. The Government has sponsored the Johnson Committee, and has committed to executing a number of the key reforms which were advocated by the Report issued by the Johnson Committee. One of the key elements in Australia's push to establish its regional credentials is its equity market. Adding further cost burden onto participants in Australia's equity markets would run counter to this objective and would weaken the sector at the very time that the Government is seeking to grow it.

(b) **Fostering employment in the financial services industry.** Australia has been suffering weak employment growth in recent years, and the Government has been providing assistance to key industries to ensure that jobs are retained in Australia. It seems illogical to pursue initiatives to preserve employment in areas such as manufacturing, where Australia's comparative advantages globally would not be strong, when at the same time add further cost recovery arrangements which would weaken employment in the financial services sector, where Australia is potentially well placed to create skilled jobs for Australians and to export services to the region.

(c) **Increasing the extent to which Australian investors to seek advice in relation to their investments.** The Government has stated a policy objective of increasing the availability of quality investment advice to ordinary Australians, and increasing the extent to which Australian investors seek investment advice. Imposing additional cost recovery on the stockbroking industry runs counter to this objective, and would exacerbate the job losses that have already followed the imposition of the existing ASIC cost recovery arrangements.

(d) **Fostering the growth of investment funds in particular, funds in superannuation accounts.** The Government has implemented various policies to introduction in the equities markets to increase efficiency and to drive down transaction costs to investors. Reductions in transaction costs have a significant bearing in the amount of funds in managed investments. The impact of a fees on the overall balance of superannuation funds over an investor's lifetime has been well documented. Whilst competition has driven down exchange fees, the introduction of cost recovery arrangements have served to load fees back onto the industry, undoing the benefits of competition. Adding further cost recovery to ensure all of ASIC's funding would further run counter to this particular Government objective.

Recommendation 30 – Strengthening the focus on competition in the financial system

Review the state of competition in the sector every three years, improve reporting of how regulators balance competition against their core objectives, identify barriers to cross-border provision of financial services and include consideration of competition in the Australian Securities and Investments Commission's mandate.

The financial markets in Australia are generally highly competitive. There are some structural areas, such as clearing and settlement, which require close ongoing consideration.

The Association has no objection to formalising the regular review of competition objectives. As regards ASIC or any other financial regulator, the drafting of the terms of any conduct consideration in their mandates should be sufficiently clear, and should not be in terms such as to override or undermine their core mandates, such as, in the case of ASIC, ensuring the efficiency and integrity of Australia's markets.

Recommendation 31 – Compliance Costs and Policy Processes

Increase the time available for industry to implement complex regulatory change.

Conduct post-implementation reviews of major regulatory changes more frequently.

The Stockbrokers Association strongly supports this Recommendation. Other than in exceptional circumstances, a minimum of 6 months lead time for implementation of regulatory change would be generally appropriate and should be mandated. Depending on the level and complexity of the changes being made, it may be that an even longer lead time may be needed.

There have been numerous examples of change in recent years that have not been well coordinated or which have allowed too little implementation time. This includes changes required by market operators as well as by regulators. Insufficient lead time can be costly for businesses to manage, and can adversely impact the planning and management of available resources. It can also lead to the potential for there to be not enough time to adequately test systems, and there have been examples where systems failures have occurred that could have been avoided with more time to undertake testing.

In addition, where regulatory change is mandated in a piecemeal or uncoordinated way, the cost impact can be exponentially greater. The cost of managing and implementing change can be minimised if changes can be grouped together and implemented in batches. The idea of change "windows" at fixed times of the year is now being implemented in some areas, and this is welcomed by industry.

The Association is supportive of the example given of 2 fixed dates each year, although 1 January (as floated) would not be welcome. There is a widespread implementation of a "change freeze" in most global institutions running from early December each year to mid/late January. Therefore, the two change windows are best situated at other times in the year so as not to run into this hurdle.

APPENDIX 1: SIGNIFICANT MATTERS (PAGES 261–276)

Recommendation 33 – Retail Corporate Bond Market

Reduce disclosure requirements for large listed corporates issuing 'simple' bonds and encourage industry to develop standard terms for 'simple' bonds.

There is general support for the streamlining of requirements to encourage the growth of the bond market. Limiting these changes to the ASX 150 companies at first instance will enable the operation of such changes to be monitored at the more liquid and well understood end of the market in case of any unforeseen impacts or complications.

Recommendation 40 – Provision of financial advice

Rename 'general advice' and require advisers and mortgage brokers to disclose ownership structures.

Some Stockbrokers Association members indicate that they support changes that would remove uncertainty in the minds of investors as to the nature of the advice that has been provided to them.

Some members support renaming the term "general advice". There is however also an opposing view that the perceived issues in this area illustrate the need for increased financial literacy rather than coming up with a new system of labelling advice.

The existing provisions of the Corporations Act contain requirements for "general advice warnings" which set out in plain terms that the advice being given does not take into account the financial circumstances of the client. Hence, it is questionable whether there are serious issues with financial literacy if investors are not capable of comprehending a warning in plain language. Alternatively, it may also indicate potential compliance failures, in that the warnings might not be being given to investors as required by law. In both of these cases, the solution would lie elsewhere than in simply changing the name.

It is noted that the FSI Final Report does not suggest a replacement for the term "general advice". However, the recent Report of the Parliamentary Joint Committee Report on Corporations and Financial Services on the Financial Services Industry, in making similar recommendations (Recommendations 1 and 2), suggests replacing the term "general advice" with "product sales information" and "personal advice" with "financial advice".

It is questionable whether these terms would not lead to just as much confusion as is presently perceived to arise from existing language. The proposals seem to be put forward based on a financial planning paradigm, which is understandable given the raft of recent inquiries have been spawned by failures in the financial planning sector. However, any new terms would have to operate clearly in all areas in which advice in relation to financial products is provided.

One common example of general advice is a piece of equity research by a research analyst employed in a stockbroking firm. Categorising a research note on, say, BHP as being "product sales information" could easily give rise to as much confusion (or possibly even more) as describing it as "general advice".

Similarly, it is hard to see why a stockbroker's personal recommendation to a client, after having taken into account the client's circumstances, is better described as "financial advice" than as "personal advice".

If the existing terms are to be changed, then any new terms should be demonstrably preferable and more clearly understood across the whole spectrum of categories of "financial product" than the ones being replaced.

Recommendation 41 – Unclaimed Monies

Define bank accounts and life insurance policies as unclaimed monies only if they are inactive for seven years.

The Stockbrokers Association supports this Recommendation.

Recommendation 44 – Corporations Act 2001 ownership restrictions

Remove market ownership restrictions from the Corporations Act 2001 once the current reforms to cross-border regulation of financial market infrastructure are complete.

The Stockbrokers Association is of the view that, once issues relating to cross-border regulation of Australia's financial market infrastructure are fully resolved, and the question of competition in clearing of cash equities determined satisfactorily, then it makes sense to reconsider whether the restrictions on ownership of the Australian Stock Exchange have any further basis and could be removed.

TAX SUMMARY

Capital gains tax concessions for assets held longer than a year provide incentives to invest in assets for which the anticipated capital gains are a larger component of returns. Reducing these concessions would lead to a more efficient allocation of funding in the economy.

The Stockbrokers Association strongly supports the retention of the existing provisions regarding capital gains tax concessions. These concessions encourage longer term investment in the share market, which is highly beneficial to the quality of Australia's equity markets. In our view, removing these concessions would lead to a significant increase in short term trading, and would increase the volatility of our share market.

The case for Dividend Imputation is less clear than in the past. To the extent that dividend imputation distorts the allocation of funding, a lower company tax rate would likely reduce such distortions.

The Stockbrokers Association is strongly of the view that Dividend imputation remains extremely important to Australia's equity markets and to listed Australian companies. Members do not consider that the case for dividend imputation has diminished, and are concerned that abolishing it would have a serious detrimental impact on the Australian share market and investment in Australian companies.

Removing dividend imputation would reduce investment in Australian entities, and as a result, increase the cost of equity capital for listed businesses. Listed companies would be more highly geared as they replace equity capital with borrowings.

Removing dividend imputation would be likely to lead to greater investment in international equities, and also in fixed interest investments (which should tend to reduce the cost of debt capital). However, the latter are influenced by a whole range of other factors as well, and it is difficult to be certain as to how much of that change in asset transfer would take place.

CONCLUSION

The Financial System Inquiry has been a timely review of key issues and trends at work in Australia's financial system. The Recommendations are thorough and deserve close consideration. The Stockbrokers Association believes that our Submissions herein better refine the Recommendations in the FSI Final report, and we urge Treasury and Government to have regard to our Submissions.

We would be happy to discuss any issues arising from our submissions on this issue. Should you require any further information, please contact Peter Stepek, Policy Executive, on (02) 8080 3200 or email pstepek@stockbrokers.org.au

Yours sincerely,

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