# Financial Services Reform Act
# A gleaning in respect of the gains, the grey and the gremlins of FSR

**Greg Drumm**
Practice Leader, Products
ANZ Banking Group Limited
Melbourne

# Financial Services Reform Act
# A gleaning in respect of the gains, the grey and the gremlins of FSR

Greg Drumm
Head of Legal, Personal Customers
Australia and New Zealand Banking Group Limited

## 1. Introduction

On any view, Financial Services Law Reform was a major change in law and practice.

The FSR Act replaced Chapters 7 and 8 of the Corporations Act 2001, repealed one Act and substantially replaced four major pieces of financial services legislation and one set of regulations[21]. It transformed multiple disclosure regimes – at least 6[22] - with a single wide-ranging framework. The Act has been supplemented with 8 sets of regulations, some of which have a major impact on the application of the Act.

ASIC[23] considered over 1000 FSR-related applications for relief and issued approximately 80 FSR-related class orders during the two year transition period. Between November 2001 and March 2004, ASIC published 14 FSR-related policy statements and 20 guidance papers. It published 139 answers to frequently asked questions.

By the end of the transition period (10 March 2004), ASIC[24] had issued 3738 AFS licences and been notified of the appointment of 32,674 authorised representatives. It had received 4132 in-use notices lodged by product issuers advising that a Product Disclosure Statement ("PDS") had been issued.

It has been reported[25] that financial services organisations spent more than $200 million to gain their Australian Financial Services licences and to train staff for FSR.

## 2. Impact on ANZ

ANZ operates a business that distributes and advises on most financial products. It also manufactures a number of financial products itself with the more sophisticated investment products and insurance being manufactured by ING Australia Ltd, a joint venture between ANZ and ING Group.

---

[21] Repealed the Insurance (Agents and Brokers) Act 1984; substantially replaced the Superannuation Industry (Supervision) Act 1998, the Retirement Savings Account Act 1997, the Insurance Act 1973, the Insurance Contracts Act 1994 and the Banking (Foreign Exchange) Regulations.

[22] These are outlined in the CLERP 6 Proposal Paper. They ranged from bank deposits where no disclosure requirements were expressly prescribed (outside the broad requirements of the Code of Banking Practice) to life insurance with a key features statement no more than 6 pages long to securities and managed funds with prospectus requirements for particular and general disclosure.

[23] See ASIC's media release 04-088 dated 29 March 2004 *Overview of ASIC's Implementation of the FSRA*

[24] see note 3.

[25] For example: Australian Financial Review 7 July p53 "Trustees groan under red tape"

ANZ was the first major Australian bank to obtain an Australian Financial Services Licence (01 October 2003). By the end of the transition period, there were few within ANZ who had not been touched by FSR. ANZ had spent millions of dollars related to FSR, filed around 30 in-use notices for PDSs for its own products and made a substantial number of operational changes. Among these changes was a new licensing regime.

## Licensing

Prior to FSR, ANZ and ANZ Group operated under almost all of then applicable licensing regimes. There were different reporting and other requirements in relation to each licence.

Under FSR, the ANZ Group now has a total of 6 licences. As a result of their structure, some financial services groups have substantially more licenses than ANZ.

It is not clear that for the regulated person – or at least the conglomerate – that FSR licensing has really delivered much in the way of simplification or efficiency. FSR extended obligations[26] across all financial services provided by a licensee that had a restricted ambit under a previous licensing regime.

For new entrants to the financial services marketplace, it may be simpler and more efficient to deal with one regulator. I suspect that for the regulator, consolidation under one licensing regime allows a more efficient and effective use of resources.

## Issues on the road to licensing

ANZ was required to communicate to staff a number of extremely complicated concepts introduced by FSR. These concepts had to be translated throughout its distribution network into policies and practices that could be easily understood and applied.

The main practical difficulties were related to advice including identifying the staff who provided advice as part of their activities and then the "triggers" for the disclosure obligations.

### *Training of Advisers*

Before discussing the concept of advice and its importance, it is relevant to first examine the major compliance requirement that is triggered by advice – the mandated training for advisers. The cost of FSRA was primarily related to this training.

FSRA states that one of the principal obligations of a financial services licensee is to ensure that its representatives are properly trained, and are competent, to provide the licensed financial services[27]. In part on the basis of this obligation[28], in its Policy Statement 146 ASIC has set minimum standards[29] of training for those who give financial product advice[30]. When

[26] see s912A Corporations Act 2001 ("CA") and ASIC Policy Statement 164

[27] s912A(1)(f) Corporations Act 2001 ("CA")

[28] ASIC Policy Statement 146 *Licensing: Training of financial product advisers* 146.19.

[29] ASIC Policy Statement 146 *Licensing: Training of financial product advisers,* Part B

ANZ licensed, compliance with ASIC's Policy Statement 146 became one of our licence conditions as it is for other licensees[31].

Mandated training for advisers was in general a new requirement for financial services organisations. Before FSR, advisers with securities and futures licensees had been required to undertake mandated training[32] and principals advising on life insurance had training obligations imposed by the Life Code[33].

This is not to say that before FSR, staff that gave advice in relation to products other than securities, futures or life insurance were untrained. At ANZ, staff were required to undergo internal programs to provide them with sufficient product knowledge, compliance and sales training.

Under ASIC's Policy Statement 146, staff advising on any financial products except some more simple financial products[34] required training equivalent to a diploma under the Australian Qualifications Framework[35]. In broad terms, a diploma can require completion of up to 5 modules, with each module taking up to 40 hours to complete. For the more simple products, the training takes approximately 20 hours to complete.

Once the initial training is completed, continuing professional development is also required[36].

The task of identifying those staff members requiring mandated training was an onerous one, taking into consideration the number of staff and the wide scope of the advice definition. Many activities not traditionally regarded by the ANZ sales and service network as giving advice were now potentially to be treated as doing so.

ANZ alone trained around 6000 advisers to the required standard. Training delivery was complicated by normal staff turnover and the fact that training was required for staff at more than 700 locations right across Australia. In addition, ANZ trained around a further 5000 staff in 'no advice' training. "No advice" training was required to ensure staff who were customer-facing did not inadvertently stray into an area where they were not qualified to go and potentially put ANZ's licence at risk.

## Advice

[30] s766B CA – in overview, a recommendation or a statement of opinion that is intended to influence a person in making a decision in relation to a *financial product*

[31] Pro Forma 209 Australian financial services licence conditions

[32] ASIC Policy Statement 138

[33] Code of Practice for Advising, Selling and Complaints Handling in the Life Insurance Industry (ISC Circular G.II.1, August 1995

[34] general insurance products (except for personal sickness and accident as defined in regulation 7.1.14); consumer credit insurance, basic deposit products and non-cash payment products.

[35] ASIC Policy Statement 146.43

[36] ASIC Policy Statement 146, Part F

Financial product advice is central to many FSR disclosure obligations and also one of the more complex FSR concepts.

Before FSR, securities advisers were familiar with the concept of a *securities recommendation*[37] but its ambit and application was very limited.

Although the Corporations Law had not done so, ASIC[38] had further refined *securities recommendation* into *personal securities recommendation* and *general securities Advice.* ASIC defined a *personal securities recommendation*[39] as a recommendation to the effect that some action in relation to certain securities or classes of securities is appropriate for a client in light of that client's individual investment objectives, financial situation and particular needs.

ASIC defined *general securities advice*[40] as advice on specific securities without any implicit recommendation that any particular action was appropriate in relation to those securities is appropriate for certain persons in light of their individual investment objectives, financial situation and particular needs

An adviser who gave a *personal securities recommendation* was required to disclose[41] material benefits, advantages and interests and to have a reasonable basis for any recommendation[42] (the "know-your-client" requirements).

An adviser who provided *general securities advice* was required[43] to disclose any conflict of interest that may affect the advice and also to adopt due care, diligence and competence in preparing advice or reports to ensure they are suitable for the investor's purpose. The adviser was also required to give a warning[44] to the client although no mandatory words were prescribed.

Under FSR, the definition as to what constituted advice expanded considerably as did its ambit in applying to all *financial products*[45]. Advice was also an important consideration in licensing.

A person could be required to hold an Australian financial services licence as a result of carrying on a financial services business[46] by providing financial product advice even in the

[37] defined in then s9 of the Corporations Law as *a recommendation with respect to securities or a class of securities, whether made expressly or by implication.*

[38] ASIC Policy Statement 122

[39] ASIC Policy Statement 122.34(a)

[40] ASIC Policy Statement 122.34(b)

[41] s849 Corporations Law

[42] s851 Corporations Law

[43] ASIC Policy Statement 122.38

[44] ASIC Policy Statement 121.73

[45] s763A CA

[46] s911A CA

absence of dealing in a financial product or where a licensing exemption for dealing applied. This is relevant to call centres and product manufacturers seeking to avail themselves of the licensing exemption where they distribute through a financial licensee[47] (as with ING Australia and ANZ). In the latter case, the continuation of the exemption is dependent on the product manufacturer's staff not providing financial product advice (except in certain limited circumstances[48]).

FSR defines *financial product advice*[49] as a recommendation or statement of opinion or a report of either of those things that:

(a) is intended to influence a person or persons in making a decision in relation to a particular financial product or class of financial products, or an interest in a particular financial product or class of financial products; or
(b) could reasonably be regarded as being intended to have such an influence.

Using the previous securities regime as a guide, FSRA divided financial product advice into two classes[50]: personal advice and general advice.

FSR defines *personal advice*[51] as financial product advice that is given or directed to a person in circumstances where the provider of the advice has considered one or more of the person's objectives, financial situation or needs or a reasonable person might expect the provider to have considered one or more of those matters.

*General advice* is defined[52] as financial product advice that is not personal advice.

Under FSR, the concept of *advice* had replaced the idea of a recommendation that some action was appropriate with the idea of a recommendation (or statement of opinion) that was intended to influence a decision, backed up by an objective view of the interaction.

The classification of *financial product advice* as *personal advice* or *general advice* results in dramatically different outcomes.

General advice is followed by a general advice warning[53]: a statement that the advice had been prepared without taking account of the client's objectives, financial situation and needs and because of that the client should consider its appropriateness. In situations related to the acquisition or possible acquisition of a financial product, the adviser is required to add that the client should obtain a PDS relating to the product and consider it before making any decision about whether to acquire the product.

---

[47] s911A(2)(b) CA

[48] see for example s911(2)(eb) or (ec) CA

[49] s766B CA

[50] s 766B(2) CA

[51] s766B(3)

[52] s766B(4)

[53] s949A CA

Personal advice is (generally[54]) followed by a Statement of Advice (SoA). An SoA is a written document that has mandated content requirements[55] which generally runs to a number of pages.

The requirement to give the general advice warning or SoA cannot be contracted out of[56]. It is a strict liability offence not to give a warning or SoA when required to do so[57].

The issue about whether *financial product advice* had been given and if so whether it was *personal advice* or *general advice* arises in a number of everyday situations:

- Do you only 'consider' something if it is raised by or with the customer at the time? For example, will a sales consultant who makes a bare recommendation of home and contents insurance be giving personal advice if she knows from looking at our records that the customer has recently purchased a house?
- Will you always give personal advice if you know something about your customer even if that information was not collected at the time the advice is given? For example, will a sales consultant be giving personal advice if he makes a bare recommendation of a savings product to a customer because he was previously told that the customer was expecting a GST refund that month?
- How extensive does the 'consideration' have to be? For example, will you always give personal advice in relation to travellers' cheques if the customer tells you s/he is going overseas?
- Can purely factual information amount to a recommendation? For example, can a comparison of fees and charges that reflects well on your transaction product amount to an implied recommendation?

The response of many financial services' providers including ANZ was that it was impossible to identify the type of advice in any given interaction. Although there were clear examples that fell into either category, at the edges the differences between general and personal advice were too complicated to be easily understood and applied.

Instead, internal ANZ rules have been developed categorising the type of advice by the nature of the financial product that is the subject of the recommendation. For example, if you ask ANZ or INGA about insurance (other than merely for a quote), you will treated as having been given personal advice and an SoA will be prepared and provided to you. At least one bank[58] requires staff to read a prepared statement following an interaction informing the customer that any advice given is general and may not be applicable to the customer's needs.

Although developing systems may minimise the risk of non-compliance with the law, the approach is not necessarily cost effective or customer friendly. At least until they may

---

[54] s946B CA sets out the situations when an SoA is not required

[55] s 947B CA

[56] s951A

[57] s 952C

[58] The Australian 03 December 2003 p27 *Tellers no sellers of advice*

become more familiar with FSR, customers may be confused by being given information by a teller and then being told the information may not be applicable to their needs. A simple SoA takes approximately 3 minutes to complete. The time taken can agitate customers and means the operator can take or make fewer calls as a result.

## Triggers

As most of you will know, FSRA disclosure centres around three documents: the Financial Services Guide ("FSG")[59]; the PDS[60] and the SoA. A licensee is required to give one or more of the documents to a retail client in different circumstances.

An FSG is generally required if a financial service is provided[61]. A PDS is generally required if a financial product (that is not a security[62]) has been recommended as a result of personal advice or is varied or issued[63]. An SoA is generally required when personal advice has been given[64].

However, there are important exceptions. For example:

- an FSG is not required[65] if the providing entity is an issuer dealing in its own products (with some exceptions);
- a PDS is not required if the customer already has a PDS that contains all the required information[66];
- an SoA is not required if the personal advice relates to a basic deposit product, non-cash payment facility or travellers' cheques.

In the course of ANZ's implementation of FSR, it readily became apparent that if the rules were applied on the basis of a particular interaction compliance risks would result. We briefly entertained the possibility of a database that would track the issue of an FSG or PDS but abandoned this in the face of complexity, cost and concern that the data would quickly become unreliable.

As a result, ANZ and most financial services organisations again do not differentiate between the various triggers and instead have rules around interaction type.

Some ANZ business units with a defined customer base mailed an FSG to every customer at the time of licensing and provide one to new customers only. Judging by the number of FSGs

---

[59] s941A CA

[60] s1012A CA

[61] s941A

[62] s1010A CA. For the definition of 'security' see s761A CA

[63] s1012A and s1012B CA

[64] s944A CA

[65] s941C(2) CA

[66] s1012D(1)

I received in particular towards the end of the transition period, a number of financial services organisations took the same approach. Other business units will provide a customer with an FSG on every occasion a financial service is provided.

Some business units with a limited product range (and a small number of customers) mailed all customers a PDS for each product. Regardless of the number of ANZ Access accounts you open, you will receive a PDS on each occasion.

## 3. Significant Outstanding Issues

Perhaps surprisingly for a reform with a two-year transition period, there are a number of issues that remain be dealt with. I will divide these into 'conceptual' issues and 'practical' issues.

FSR had been signalled for some time[67] but it seems when it came, it arrived at great speed. It is a fair criticism of industry that when the legislation was enacted with an effective date two years away, it took some time for FSR to gain the attention it required. However, it is also fair to say that FSR is very complex and it took some time to digest its full impact.

A large part of the transition period was also spent absorbing the requirements of changing requirements delivered through the various batches of regulations rather than simply implementing requirements that had remained static from the commencement of the transition period. At times, it seemed the transition period was spent in almost constant dialogue with Treasury and ASIC and focussing with an increasing urgency on completing what was required before the end of the transition period. There has been little time to reflect and therefore it is probably too soon to say for certain what is the total impact – for better or worse – of FSR.

Nevertheless, some issues are apparent. On the 'conceptual' side there is concern about regulatory overload; about certain financial products becoming unavailable to retail clients and about advice becoming unavailable to retail clients. On the 'practical' side, the issues are about dollar disclosure; hybrids; call centres and time critical disclosures. There are also practical issues for New Zealand financial services organisations.

There are a number of other issues such as loyalty schemes (are they a non-cash payment facility[68]), the clerks and cashiers exemption to providing a financial service[69] (what does it mean? How does it differ from *arranging to deal*[70]?) and the extent of disclosure about corporate authorised representatives in an FSG[71] who are temporary branch staff (the exemption[72] does not extend to where personal advice is given).

[67] FSR was the legislative response to a number of recommendations of the Financial System Inquiry, which released its final report ("the Wallis Report") on 10 April 1997.

[68] see ASIC's media release IR 04/06 ASIC Guidelines for Interim relief for Loyalty Schemes dated 24 February 2004.

[69] s766(3) CA

[70] s766C(2) CA

[71] s942C CA

[72] Regulation 7.7.05B

## 3.1 Conceptual Issues

### Regulatory Overload

FSR was in itself a complex and substantial piece of law reform. However, it has been only part of a greater volume of regulatory change that threatens to exhaust the financial services industry, if it has not already done so.

We have had anti-money laundering legislation[73], new corporate governance proposals and law[74]; new general insurance law[75]; credit interchange reform[76], a review of the *Code of Banking Practice* and the introduction of international financial reporting standards[77] from next year – to name but a few. There is a limit to how much reform industry can be expected to digest.

In addition to the sheer volume of regulatory change of which FSR is only part, regulation of financial services has become piecemeal and threatens to overwhelm the consumer. This is most apparent in financial services advertising. A relative simple advertisement – and especially one that spans financial products and credit – must now contain an amount of legal content of doubtful relevance to the viewer.

For example an ANZ advertisement that refers to an insurance product must contain these words[78]:

*Australia and New Zealand Banking Group Limited. ANZ recommends you read the Product Disclosure Statement which is available by calling 13 131 4 or visiting www.anz.com before deciding to acquire the product.*

If the advertisement recommends the product or contains a statement of opinion about it, it must also contain the general advice warning[79]. If the advertisement is *public marketing material* (television, radio, internet, billboard or poster), the general advice warning may be abbreviated[80].

The full general advice warning is:

---

[73] the most publicised to date being the US legislation the USA PATRIOT Act (Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act) and the recommendations of the United Nations' Financial Action Task Force

[74] for example, the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004

[75] General Insurance Reform Act 2001

[76] following the *Reform of Credit Card Schemes in Australia*, Reserve Bank of Australia August 2002

[77] the introduction of International Financial Reporting Standards is scheduled for 01 January 2005

[78] s1018A CA

[79] s949A CA

[80] Regulation 7.7.02(5A)

*This material does not take into account your objectives, personal needs or financial circumstances and you should consider whether it is appropriate for you.*

The abbreviated general advice warning is:

*You should consider whether this product is appropriate for you.*

If the advertisement of the insurance product also referred to an interest rate (for example a term deposit) the advertisement would need to include words required by the Code of Banking Practice[81].

The Code of Banking Practice requires the advertisement to state whether fees and charges apply and that full details of the relevant terms and conditions are available on request.

If the interest rate stated were an interest rate of most loan products, in addition the advertisement would be required to state a comparison rate[82] and include the following words:

*A comparison rate of [x]% p.a applies for a [name of loan] based on a secured amount of $[x] for a term of [x] years. A schedule of comparison rates is available at any ANZ branch or on www.anz.com . Care should be taken in using this comparison rate. The comparison rate is accurate only for the example given as other factors, including redraw fees or fees for early repayment, may influence the final cost of the loan.*

In print advertising, there may less need for an abbreviated legal disclosure, although I would suggest that an advertisement attracting the full legal requirements of both credit and financial products regimes is unlikely. However, with television advertising and even more particularly radio advertising time is money. As a result, as has already occurred with comparison rates, advertisements for financial products may become less informative for consumers.

Reputable financial services' advertisers are not opposed to making appropriate disclosure in advertisements. Even apart from the requirement not mislead or deceive consumers[83], there is little purpose to be served in building expectations in present or future customers only to dash those expectations when the full nature of the product proposition is outlined. However, there is a concern around required content in advertisements that does not help consumers or may overwhelm them.

### Retail clients

The disclosure obligations of FSR relate to interactions with *retail clients*. Exactly who is a retail client may depend on the type of product or the value of the product and there are a number of exceptions to the general rules.

---

[81] Clause 30 *Code of Banking Practice* Australian Bankers' Association

[82] Consumer Credit (Queensland) Amendment Act 2002; Consumer Credit Amendment Regulation (No 1) 2003

[83] for financial services, s12DA Australian Securities and Investments Commission Act 2001

The definition of 'retail client[84]' includes a businesses involved in the manufacture of goods employing less than 100 people or any other business employing less than 20 people. Superannuation and retirement savings account products are always provided to a person as a retail client while for general insurance every individual is a retail client.

As a result, the disclosure obligations extend well beyond the group that may traditionally have been characterised as retail clients. In addition, a financial product or financial service is taken as being provided to a retail client unless the provider can establish that one of the exceptions applies[85].

It is simply too difficult to monitor the status of different clients, especially those 'on the cusp' or where the client's status as wholesale or retail can change depending on the type of product or product value. A business that acquired a particular financial product when it was a 'wholesale' client can be treated as a wholesale client in future interaction related to that particular product even if the definition of retail client then applies[86]. However a licensee will commit an offence[87] and potentially put its licence in jeopardy[88] on the day it issues a financial product without the disclosure required to a client that is a manufacturer of goods that normally has 110 employees but has restructured to 90.

As a result of the variable application of the definition of 'retail client' and the obligation on the provider to get it right, ANZ treats all customers in or below its Corporate Banking division (lending up to AUD200 million) as a *retail client*.

## Availability of Products to Retail Clients

As previously outlined, large financial organisations often resort to rules of general application rather than relying on rules for individual situations. Where a majority or a substantial number of an organisation's customers are *retail clients*, it will often be easier to treat all clients as retail – as ANZ's Corporate Banking division has done - rather than attempt to differentiate between them, especially using the complex classification rules of FSR.

The problem arises where a majority or a substantial number of an organisation's customers are 'wholesale' clients and only a small percentage – by number or value – are *retail clients*. The law prohibits an organisation in this situation from treating all clients as 'wholesale' and prohibits clients who meet the definition of *retail client* from agreeing to be treated as anything other than a *retail client*.

For its wholesale clients, the organisation is not required to provide any of the FSR disclosure documents. For an organisation where a minority of its customers are *retail clients*, the obligations imposed by FSR become cumbersome and costly, in particular the SoA.

---

84 s761G CA

85 s761G(1) and s761G(8) and (9) CA

86 Regulation 7.1.27

87 for example, (s952C CA) failure to give an FSG when required is a strict liability offence attracting a penalty of 50 penalty units ($5,500)

88 s915C CA

When giving *personal advice* to its wholesale clients, the interaction is legally complete when the call ends. For risk reasons, the adviser may choose to make a diary note but is not required to do so.

When giving *personal advice* to a retail client, the adviser[89] must complete an SoA. An SoA is required even if the client rejects the advice. If the personal advice is given by telephone or in any other situation when the SoA is not given at the time the advice is provided, the adviser must give certain information at the time of giving the advice and then send the SoA to the client within 5 days[90]. The adviser is not able to provide the client with any further financial service that arises out of or is connected with the advice until the SoA is given to the client[91].

In those situations where the SoA is not given with the advice, the adviser will need to keep a reasonably detailed record of the advice at or about the time of the call to enable the SoA to be completed later. An SoA for straightforward personal advice generally takes at least 3 minutes to complete. If the adviser interacts with a number of retail clients, it does not take long before the time for completing the disclosure requirements starts to add up.

Even if no advice is given, the interaction with a retail client may trigger the need to provide a PDS[92]. A PDS will also be required if the *personal advice* consists of or includes a recommendation to acquire a financial product. If the interaction occurred over the phone and the situation is time critical[93], the adviser will have to remember to at least offer the substitute information[94] about the PDS and then ensure the PDS is sent to the caller within the prescribed time[95]. If the retail client wants to be provided with the substitute information the adviser must then provide information[96] including the essential features of the product, its significant risks and the relevant dispute resolution system. The adviser will be lucky to complete this within another 3 minutes.

As a result, each interaction with a retail client – which does not necessarily involve a sale - will generally take an adviser at least 3 minutes and potentially at least 6 minutes longer than an equivalent interaction with a wholesale client. This does not include time for arranging the disclosure documents to be sent. An adviser making 20 calls a day (even if all were unsuccessful) could be adding at least 2 hours to his or her day to complete the FSR disclosure requirements.

The impact of FSR disclosure for retail clients is most relevant in the investment banking area. This is the area that works with clients to develop effective strategies utilising the full

---

[89] there is a limited exception available for certain products able to be traded on an approved foreign market (ASIC Class Order 04/10) and in situations of further market-related advice

[90] s946C(3) CA

[91] s946c(1) CA

[92] s1012A CA

[93] s1012G(2) CA

[94] Regulation 7.9.80C

[95] s1012G(3)(b) CA

[96] s1012G(3) CA

range of derivative products available, including the packaging, designing and pricing of complex derivative structures.

Derivatives are important risk management tools in particular for managing exchange rate and interest rate potential volatility. They are also a financial product[97] regulated by FSR. Due to the nature of the product, derivatives are mainly used by larger corporations – 'wholesale' clients – but also for managing exchange rate risk by smaller businesses such as farmers and exporters/importers.

Many in this latter group are *retail clients*. They are usually easily a minority in value and number of the total group interacting in relation to derivatives. Most of the interactions in relation to derivatives will be by telephone with a product specialist or dealer. Most of the advice given to a retail client will be *personal advice* because at the very least any recommendation made will have followed a consideration of one of the client's objectives, financial situation or needs. Many calls will also involve the offer of the derivative or personal advice consisting of or including a recommendation to acquire the derivative. As a result, this will trigger the requirement at least to offer of the PDS substitute information and send a PDS to the client. Most derivatives are traded in limited time periods. It is costly to have a dealer take time to complete a SoA following personal advice to a retail client or to provide the substitute PDS information (and arrange for the PDS to be sent), especially when the time could more profitably be spent on more substantial clients and interactions.

It is therefore tempting for an organisation in this situation not to interact with retail clients or at least not to provide them with any advice. Alternatively retail clients may be dealt with by an organisation or area that charges for the additional compliance costs.

The Australian Bankers' Association has recently suggested amending the definition of retail client for derivatives. An incorporated businesses including farming requiring derivatives would be treated as 'wholesale' where a business purposes test had been satisfied. The current definition of *retail client* would continue to apply to individuals requiring derivatives. Adjusting the definition in this way would, in my view, represent a sensible outcome for this particular area.

**Availability of Advice to Retail Clients**

As set out above, from the adviser's perspective, the requirement to give an SoA when giving *personal advice* to *retail clients* is time-consuming and expensive, especially when the cost of training is also factored in. A solution – which we can already see some evidence of – is simply not to provide retail clients with personal advice. In cases where the boundaries between *personal advice* and *general advice* are not clear, not providing *personal advice* means that the organisation will not provide any advice to retail clients.

An alternative is to charge retail clients for advice to recover the compliance costs.

It would be unfortunate if retail clients – who are often in greater need for financial product advice than 'wholesale' clients – were denied access to advice or provided it at a fee because of the compliance costs in the absence of evidence that justified those costs.

In addition, there is concern about the 'human' factor that does arise when faced with complex and time-consuming compliance requirements. A person dealing with a customer who has a number of dependent children may notice that the customer does not have any

---

[97] s764A(1)(c) CA

life insurance but not raise the topic because to do so will require the teller to provide the PDS and complete a SoA when a sale may not necessarily result.

I would hope that this does not occur but I fear that it may be naïf to think that it does not.

### 3.2 Practical Issues

#### Dollar Disclosure

Dollar disclosure is a substantial practical issue.

As a result of a recent addition to FSR[98], from 01 January 2005 financial services licensees will be required to state as dollar amounts (inter alia):

PDS[99]

(a) any significant benefits to which a holder of the product will or may become entitled;

(b) information about the cost of the product;

(c) any commission or other similar payments that will or may impact on the amount of such a return.

SoA[100]

(a) information about any remuneration (including commission) and other benefits that might reasonably be expected to be capable of influencing the advice received by (inter alia) the adviser and the licensee;

(b) information about any other interests whether pecuniary or not and whether direct or indirect of the providing entity or of any associate of the providing entity.

Any exception to this obligation requires a determination[101] by ASIC that for a *compelling reason it is not possible* to state information in dollar terms.

At present[102], a licensee is required to make these disclosures but may express them in dollar terms, as a percentage rate or as a description of how the various amounts are calculated.

On its face, requiring dollar disclosure is a worthy goal: figures have generally much more meaning for and are more easily understood by consumers than written explanations of how various amounts are calculated. Dollar disclosure might also drive licensees towards simpler

---

[98] Financial Services Reform Amendment Act 2003 assented to 17 December 2003; Corporations Amendment Regulations 2004 (No 6) made 24 June 2004

[99] Regulation 7.9.15B Corporations Amendment Regulations 2004 (No 6)

[100] Regulation 7.7.11 Corporations Amendment Regulations 2004 (No 6)

[101] Regulation 7.7.11(2) and (3); Regulation 7.9.15B Corporations Amendment Regulations 2004 (No 6)

[102] the previous regulations providing for this disclosure as a descending 'scale' (Corporations Amendment Regulations 2003 (No 8) 2003 were disallowed on 24 March 2004

fee and commission structures that will make the costs of a financial product and any motivations promoting its sale more easily understood. No reasonable licensee should have any proper objection to improved disclosure to assist consumers to 'shop around' and compare financial products.

However, there is a balance between these goals and the imposition of a universal obligation regardless of scale, cost and workability.

There are some financial products where it is clearly not possible to disclose some of the information required in dollar terms. These are financial products – generally derivatives – where even the cost of the product may be set by some future event (the closing price of an index or a comparison between prevailing interest rates and a future interest rate).

However, for other financial products calculating benefits and costs may be extremely difficult and costly but it is not clear whether doing so can be said to be *not possible*.

ASIC will provide some guidance on how it will approach dollar disclosure hopefully by the end of July. It may be that some of the issues referred to below will be addressed or impacts lessened when that guidance comes.

The first concern is timing. At present the extent of any exceptions to dollar disclosure are simply unknown. If technology changes are required - which on almost any view of the ambit of the requirements will be the case – then the window for implementation is extremely limited. To ensure that systems are fully functioning for the huge increase in transaction processing in the lead up to Christmas, most banks have a period beginning around mid November and which ends mid to late January during which system changes are not permitted. I am sure every bank has horror stories of apparently minor system changes that have caused unintentional upheaval. As a result, if any system changes are required, the real implementation date for dollar disclosure is around mid-November.

I think it is also fair to say that implementation by 01 January 2005 will place substantial demands on ASIC particularly if it is going to apply the test for exceptions on an individual product basis.

Secondly, perhaps until ASIC provides its guidance to industry, the extent of the dollar disclosure requirements is not presently known.

For many financial products, one of the obvious significant benefits to which the holder becomes entitled is interest. It is the common practice within the industry to express the interest to be paid on a financial product as a percentage rate. It is also something that customers are familiar with and understand. It now appears that dollar disclosure will require a licensee to tell a customer who invests $1000 for one year at 5%pa in the PDS provided at the time of deposit that the customer will earn $50 in interest. It is not clear whether this means the term deposit customer will have to be provided with an 'individualised' PDS.

If dollar disclosure requires the development of an individualised PDS, the product provider will be looking at significant systems, procedural, administrative and cost implications. Many financial products would require the development of an individualised PDS because some or all of the information that needs to be included in a PDS as a dollar amount will not be known until the financial product is issued.

It is also not clear what 'significant benefits' are.

From a consumer's perspective, one of the significant benefits of choosing an ANZ Access Advantage account over an ANZ Passbook Savings account is the flexibility allowed by electronic access (internet banking and ATMs) 24 hours a day, 7 days a week. Is this a significant benefit that is required to be expressed in dollar terms? If so how is it valued?

A farm management deposit holder obtains a tax benefit from holding the account. Indeed, the whole purpose of this type of account is to provide the tax benefit. It would be extremely difficult (but *not possible*?) to quantify the benefit as the value of the benefit depends on when the customer wants to withdraw money from the account. To estimate the benefit may mislead the account holder.

For SoAs, the issues may be more straightforward but still require some careful consideration.

In relation to disclosure of commissions, the regulations seem to be premised on the basis that when an adviser provides personal advice that results in the issue of a financial product, the adviser will receive either a fixed dollar amount or a percentage of the value of the product. In other words, if a financial product worth $100 is sold as a result of the advice, the adviser will receive say $10.

In reality, for most advisers, the amount of commission received for any particular sale is not so straightforward. An adviser's commission may be a mix of factors relating to the sale and quality factors. For example, while the value of the sale may form a basis for the commission payable, other factors such as client satisfaction, practice management (compliance) and contribution to leadership and teamwork will be important factors in determining the amount of commission actually paid. These factors will rarely be known at the time.

If dollar disclosure of commission allows an estimate in dollar terms (not to be exceeded), then it is likely that no real issue will arise for statements of advice. However, if dollar disclosure requires the actual amount of commission to be stated, then the only practical way this could be done is to remove the quality factors and return to a commission related to the sale or sale amount.

### Hybrid Products

There are a number of products that are only in part financial products. For example, a credit card may be combined with general insurance (usually travel insurance) or a loyalty program. A margin loan may be combined with an option allowing the customer to sell to the lender any securities that have fallen in value at the original purchase price in full repayment of the debt.

A credit card or a margin loan is a credit facility.[103] A credit facility is not regulated by FSR.[104] However, financial products are. General insurance is specifically named as a financial product.[105] ASIC considers a loyalty program may be a financial product as a result of being a facility through which a person makes non-cash payments.[106] The option in the margin loan

---

[103] Regulation 7.1.06.

[104] s765A(h)(i) CA.

[105] s764A(1)(d) CA.

[106] see ASIC's frequently asked question no 120 'How are non-cash payment facilities regulated?'

is a financial product by virtue of being a facility through which a person manages financial risk,[107] specifically a derivative.[108]

FSR deals with hybrid facilities in one of two ways. If the financial product is only an incidental component of the overall facility, the financial product will not be regulated by FSR.[109] On the other hand, if the financial product is part of a broader facility but not incidental to it, FSR will apply to the part of the facility that is a financial product but not to the other parts of the facility.[110]

It is not always easy to determine whether a financial product is incidental to the facility as a whole. FSR provides that a financial product will be an incidental component if it is reasonable to assume the main purpose of the overall facility is not a financial product purpose[111] *and* the financial product is not one of the things specifically named as a financial product in s 764A of the *Corporations Act*.[112]

In relation to the examples referred to above, general insurance and derivatives are named as financial products in s764A. As a result, by definition they cannot be incidental to a facility and so will be regulated by FSR. The other components of the overall facility (the credit card and the margin loan respectively) will remain unregulated by FSR.

There are some difficult consequences of hybrid facilities consisting of products regulated in part by FSR. Although *the Corporations Act* may divide the components of a hybrid facility between Ch 7 and other regulated components, in practice, this division is not always made when the product is sold or recommended. This leads to difficult issues related to documentation and financial product advice.

For most hybrids, the credit provider will offer to issue, or issue, the financial product to the retail client at the same time as the overall facility.

In personal advice or issue situations, unless the financial product is only an incidental component of the hybrid facility, a PDS will be required for the financial product part of the hybrid facility.

The primary exception is a credit card that has insurance as an additional benefit to the cardholder. Typically, the insurance arrangements will be entered into between the card issuer and the insurer with the cardholders (and possibly others, such as partners and relatives) being beneficiaries under the policy.

As the cardholder is not a party to the insurance contract, even if financial product advice is given, the advice cannot consist of or include a recommendation to the cardholder to acquire the insurance. For the same reason, neither the card issuer nor the insurer makes an offer

---

107 s763A(1) CA

108 s761D CA.

109 s763E CA.

110 s762B CA

111 Financial product purpose is defined in s763E(2) CA.

112 s763E(1) CA.

relating to the issue of, or issues, the insurance to the cardholder. As a result, a PDS for the insurance is not required.

In many cases with hybrid facilities, the actual recommendation may relate to the non-financial product features. For example, in some limited circumstances, such as when the cardholder discloses imminent travel, a credit card issuer may recommend a particular credit card on the basis that it also provides travel insurance as an additional cardholder benefit. However, in most cases the recommendation will be made because of another feature of the credit card, such as the interest free period or the ability to earn reward points.

At first glance it would seem that the definition of financial product advice extends to a recommendation that does not necessarily have to be about the financial product. Certainly, the definition does not expressly require it to be so. Further, the decision the recommendation is intended to influence is only one *in relation to* a particular financial product. On this analysis, using the example of a credit card with insurance, because the insurance is indivisible from the credit card, a recommendation of the credit card on any basis would be considered to be intended to influence a person in making a decision in relation to the insurance even though there was no direct communication about the insurance.

This view would leave the anomalous situation that financial product advice could be given where a hybrid facility is recommended without reference to its financial product component and even in a situation where the applicant was not aware at that time that the hybrid facility had a financial product component.

Another view is that for a hybrid product, financial product advice will occur only where the financial product is referred to but may still be given even if the primary message does not refer to the financial product component. For example, a person may recommend a credit card and list its features without elaboration ('We recommend our XY credit card which has the following additional features ...'). If one of those features is travel insurance, it is at least arguable that the recommendation of the credit card is intended to influence the applicant in making a decision in relation to a particular financial product. As a result, the statement would constitute financial product advice. If financial product advice is given, in addition to providing a general advice warning or statement of advice, the person making the statement will need to have the appropriate level of training set out in ASIC's Policy Statement 146 Licensing: Training of financial product advisers.

Unlike the requirements relating to PDSs, the definition of financial product advice is not limited to situations where a person makes an offer to issue, or issues, a retail client with a financial product. It extends to situations where a person intends to influence a decision in relation to a particular financial product or an interest in a particular financial product. The definition of financial product advice is likely to include recommendations or statements of opinion in relation to hybrid facilities where the financial product component is not issued to the retail client. In those situations the retail client is likely to have been influenced in relation to an interest in a particular financial product even if the financial product itself is not actually able to be acquired by the retail client.

### *Call Centres*

Call centres have come to play an important part in the delivery of financial products and services. Financial services organisations use call centres because they are a cost-effective delivery channel. Customers use call centres because of convenience. FSR poses issues for call centres touching on both cost and convenience.

FSR does permit issuing financial products and even providing *personal advice* over the phone before the delivery of the required documents, but only in limited circumstances.

In general, FSR requires a client to be given an FSG as soon as practicable after it becomes apparent that a financial service would be provided (and in any event before the service is provided) and a PDS at the time of or before issue of the insurance. For obvious reasons, this would mean that the caller could not proceed with the transaction by telephone. However, FSR permits a person to provide the FSG[113] and PDS[114] later if the caller expressly instructs that he or she requires the financial service to be provided immediately or by a specified time *and* it is not reasonably practicable to give the FSG or the PDS before the service is provided as instructed. The operator must offer[115] or provide[116] certain information derived from the FSG and PDS in the course of the call.

Take as an example the caller who phones to obtain home and contents insurance for a house purchase. The caller is a new customer who had previously obtained a quote. No advice is sought or given. In this example, as with ANZ's insurance products, the insurance is issued by another financial services organisation.

The first issue that arises will affect the more prudent caller who attempts to arrange insurance in advance of his/her need. If the caller did not expressly instruct that he or she required the insurance immediately, say because the house purchase was to occur in the following week, the caller might be surprised to be told that the transaction will be delayed because the operator would need to provide the caller with an FSG before the insurance could be arranged.

The caller will then receive the FSG. This is the document that *can be characterised from the client's perspective as … what financial service am I getting?*[117]. The value of the FSG in this context is questionable considering the caller initiated the contact with the service provider and knew what financial service he/she was seeking (to obtain insurance). A caller may well be confused as to why the provision of such a document in these circumstances had to delay the transaction.

If the caller received the FSG in a few days and phoned back to complete the insurance purchase, the issue of the insurance may be further delayed if it was still reasonably practicable to give the PDS before the caller required it and the caller did not expressly instruct that the insurance was to be provided immediately (after all the house purchase is still some days away).

In the above example, it could take up to five days from the time the customer first called the service provider for the insurance to be arranged.

In contrast, for the caller who has left the arrangement of insurance to the last moment, the operator may arrange for the insurance immediately provided the caller receives the

---

113 s941D(2) CA

114 s1012G CA

115 in relation to the PDS, regulation 7.9.80C allows the operator to offer the information but the operator is only required to provide the information if the caller wants it to be provided then.

116 For the FSG, s941D(3) and for the PDS, s1012G(3)

117 ASIC Policy Statement 175.31

substitute information (or, in relation to the PDS, the offer to provide it and chooses not to receive it) and is then sent the FSG and PDS within five days 'or sooner if practicable'.

In place of the FSG[118], the operator must give the caller a statement about remuneration, benefits and associations reasonably capable of influencing the providing entity and additional information if the provider acts under a binder.

In place of a PDS[119], the operator must tell the client the:

- name and contact details of the product issuer;
- information about the essential features of the product; and
- information that would be in the PDS about the cost of the product and other amounts that may be payable in relation to the product, any significant risks associated with the product, information about the available dispute resolution system and any applicable cooling off period.

This information does not need to be given if the caller elects not to receive the information[120] but before this election can be made the operator must have told the caller:

- of the *nature of the information* in the PDS about the matters referred to above; and
- of the importance of the using the information in a PDS when making a decision to acquire a product.

As a less organised caller will expressly instruct that they require the requested services and products immediately, they will receive the benefit of immediate fulfilment of their request, whereas in the first example, the service provider may be prevented from providing a similar service to the prudent customer.

If any financial product advice had been given, the operator would in addition have been required to give either the 'general advice warning[121]' at the same time or, if personal financial product advice is required immediately, certain other information immediately[122] and a statement of advice within five days 'or sooner if 'practicable'[123]. As with the FSG and the PDS, in the case of personal financial product advice, the possibility of giving the SoA later only arises if it is not reasonably practicable to give the SoA to the caller before the further service is to be provided.

If personal financial product advice had been given, the other information to be given relates to remuneration of the providing entity or the operator (among others) and information about

---

[118] s941D(3) CA

[119] s1012G(3) CA

[120] regulation 7.9.80C

[121] s949A CA

[122] s946C(2) CA

[123] s946C(3)(c) CA

any other interests, associations or relationships that might be capable of influencing the advice given.

The financial services provider would be unable to provide any further financial service arising out of or connected with the advice until the SoA is sent, unless the customer expressly instructs they require that further service immediately[124].

The length of the disclosure depends on the type of financial product. In particular, there are concessions of the amount of disclosure and documentation required for basic deposit products and non-cash payment facilities. However, the impact of the disclosure and documentation requirements on a call centre can have major implications.

As set out above, in a time critical case, for the sale with no advice of a relatively simple product like general insurance, the operator is required to offer or provide information about:

- the remuneration or other benefits attributable to the sale received by the providing entity and the operator (among others);
- any associations or relationships between the providing entity and the product issuer (among others);
- acting under a binder, if one exists;
- the name and contact details of the issuer of the insurance;
- the essential features of the financial product;
- any significant risks about holding the product;
- the cost of the product;
- the dispute resolution system that covers complaints by holders of the product and about how that system can be accessed; and
- the applicable cooling off period.

In addition, the operator must arrange for an FSG and a PDS to be sent to the caller.

If financial product advice had been given, the operator would have been required to give either the general advice warning or information about remuneration capable of influencing the advice and information about interests, associations or relationships capable of influencing the advice, both of which may be more extensive than the information provided in place of the FSG. Where personal financial product advice is given, the operator must also arrange for an SoA to be given to the caller.

A prudent customer may be able to obtain insurance over the phone but not on the first call. Indeed such a customer may face the prospect of up to three calls over up to five days to be able to obtain insurance if his or her requirements are only made known in stages. A less organised customer will be able to make arrangements immediately. Ironically, the prudent customer is perhaps less likely to make an incorrect decision than a customer who has not allowed time to make a considered decision.

124 s946C(1) CA

A conservative estimate of the time required to complete the wording requirements is three minutes per call, but some financial services providers have estimated that the requirements may add up to five minutes per call.

While it may be relatively easy for the operator with access to automated systems to arrange for an FSG and PDS to be sent to the caller, the SoA requires detailed input that only the operator can provide. The time taken to complete an SoA — for a simple advice situation — is approximately three minutes.

In isolation, the additional time may not appear to be substantial. However, assuming the average additional time required to complete a call which results in a sale of a financial product is three minutes (not every call will require a statement of advice) and 100 calls resulting in sales are received in a day, 300 minutes or five hours are added to the total time to complete the same number of calls than was the case before the FSR. The additional total time involved for the call centres of major financial services providers is substantial.

The only way to allow for the additional completion time is to reduce the number of calls or increase the number of operators. Either solution involves increased costs.

There is no dispute that a customer has a right to material information about a product before purchase or about the basis on which advice is given. Reputable financial services organisations are well aware that a customer who feels pushed into a purchase or has received advice that only benefited the advice provider is unlikely to consider purchasing other products or services and will relate the unhappy experience to others. For call centres and customers of call centres the question to be answered over time is whether the FSRA has struck the correct balance in providing information and the cost and possible inconvenience of doing so.

**FSR and New Zealand**

In FSR terms, as they are presently structured[125], it is unlikely that a separately incorporated New Zealand bank[126] would be considered to carrying on a financial services business[127] in Australia, which would (in addition to other consequences) require an Australian financial services licence[128].

In the event of any uncertainty, ASIC has issued class order relief[129] that means that New Zealand financial services organisations are exempt from the requirement to obtain an Australian financial services licence in relation to financial services provided to 'wholesale' clients.

Outside of licensing however, FSR does raise some issues for New Zealand financial services organisations. Australia and New Zealand obviously share a close relationship in most financial services fields. Certainly the banks have clear protocols about management of

[125] The former Bank of New Zealand branches in Australia are now part of National Australia Bank Limited.

[126] Westpac Banking Corporation operates in New Zealand as a branch of the Australian corporation.

[127] s911D CA

[128] s911A CA

[129] ASIC Class Order 03/824. The class order applies on its terms without the need to make any application or request.

customers when customers 'migrate' from the New Zealand bank to the Australian bank and vice versa. However, New Zealand financial services organisations may need to take some care with retail clients in transition or with one foot in each country.

The definition of financial product advice[130] is not restricted only to advice about a financial product that is domiciled in Australia. The definition of *financial product*[131] or *dealing*[132] (of most relevance is *applying for a financial product* or *issuing a financial product*) is not restricted to financial products that are domiciled in Australia.

The issue is likely to arise in an incidental way. An Australian resident intending to migrate to New Zealand may telephone a New Zealand bank asking for a recommendation as to which of its transaction accounts to open. Perhaps the caller is a former New Zealand resident who still has a banking relationship with a New Zealand bank and wants to change accounts. It may be a New Zealand resident on holiday in Australia who wants to know the best way to make an overlooked payment.

If the New Zealand bank responds it is likely to have provided financial product advice in Australia but unlikely to provide the general advice warning much less (where required) an SoA and the information required to be given in the course of the call. If the New Zealand bank also then offers to issue the transaction account, it is unlikely to provide the caller with the required substitute PDS information, much less send the caller a PDS (or at least terms and conditions that meet the PDS requirements). The actual issue of the product will occur in New Zealand.

Even if the New Zealand bank is alive to the issues raised when dealing with Australian residents it may not be made clear to the New Zealand bank until much later in the call if at all that the caller is resident in Australia.

It is not clear if this issue has been raised with ASIC. It may be ASIC would consider class order relief for New Zealand financial services organisations (perhaps restricted to those regulated by an equivalent to the Australian Prudential Regulation Authority) providing incidental financial services to Australian residents. If not then it will be a difficult issue for New Zealand banks to guard against.

## 4. FSR in overview

The finding of the Financial System Inquiry was that financial system regulation was then piecemeal and varied, determined by the particular industry and the product being provided. It is hard to disagree with the Inquiry's recommendation that we move to a single licensing regime with consistent and comparable financial product disclosure.

In introducing the Bill to the Senate, the then Minister for Financial Services and Regulation promised[133] that FSR would deliver more uniform regulation, reduced administrative and compliance costs and remove unnecessary distinctions between products. It was also to give

[130] s766B CA

[131] s763A CA

[132] s766C CA

[133] Revised Explanatory Memorandum (Senate) paragraph 1.5

consumers a more consistent framework of consumer protection in which to make their financial decisions.

The question is whether FSR has delivered the promised benefits and if so whether the benefits of FSR have outweighed its (significant) costs. At this point, I think it is too early to provide an answer.

*The views expressed in this article are those of the author and do not necessarily reflect the views of ANZ.*