Chapter 7
Summary . . .

Conduct and Disclosure

Overview

- Financial markets cannot work well unless participants act with integrity and there is adequate disclosure to facilitate informed judgments. This chapter considers financial regulation which addresses these objectives.

Key Findings

- Conduct and disclosure regulation are currently undertaken by a variety of agencies, with most based on the institutional form of the service provider.
- This is inconsistent with the broadening structure of markets, has resulted in inefficiencies, inconsistencies and regulatory gaps, and is not conducive to competition in the financial system.

Key Recommendations

- At the Commonwealth level, a single market integrity and consumer protection regulator, the Corporations and Financial Services Commission (CFSC), should be created combining the Australian Securities Commission, that part of the Insurance and Superannuation Commission dealing with disclosure, sales and advice, and the codes of practice overseen by the Australian Payments System Council.

- In addition to other enforcement powers, the CFSC should be given powers, exercisable within its jurisdiction, which mirror those provided under the consumer protection provisions of the *Trade Practices Act 1974* and exclusive responsibility for their administration.
- Existing inconsistencies within and between various disclosure laws should be removed, in particular by ensuring that specific due diligence defences, which have a vital role in an efficient financial market, have full effect.
- Responsibility for the *Uniform Consumer Credit Code* should be retained by the States and Territories, subject to review after further experience with the Code.
- The CFSC should seek to establish a consistent and comprehensive disclosure regime for the whole financial system, based on product profile statements which provide a better balance between effectiveness and cost.
- The CFSC should have responsibility for the regulation of sales and advice on retail financial products including the licensing, within a single licensing regime, of all financial advisers.
- The current distinction in the *Corporations Law* between securities and futures contracts should be replaced by a single regime for financial markets and instruments.
- The CFSC should oversee industry based schemes for complaints handling and dispute resolution, including establishing common access for consumers.

Chapter 7

Conduct and Disclosure

7.1 Introduction

As discussed in Chapter 5, the objectives of the regulation of market conduct and disclosure in the financial system are similar to those applying in all markets. However, while these objectives apply generally, the means of achieving them often need to take specific forms due to the complex nature of financial products. This chapter considers areas of financial regulation which address potential market failure arising from two sources:[1]

- unfair or fraudulent conduct by market participants;[2] and
- inadequate disclosure of information on which investors and consumers can make informed choices about financial products and their providers.

Financial regulation for these purposes usually takes two broad forms. The first, referred to as market integrity regulation, seeks both to promote market development through securing greater confidence and to protect participants from fraud or other unfair practices. It applies across all financial products and services with the intention of ensuring that:

- markets are sound, orderly and transparent;
- users are treated fairly;
- the price formation process is reliable; and
- markets are free from misleading, manipulative or abusive conduct.

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1 Market failure refers to factors, such as barriers to entry, information imbalances and externalities, which prevent a market from operating efficiently.

2 Market participants include financial institutions, other entities offering financial products, and dealers in, and advisers on, financial products.

The second form of regulation, referred to as consumer protection, aims to ensure that retail customers have adequate information, are treated fairly and have adequate avenues for redress. It includes explicit disclosure obligations, regulation of the conduct of distribution and advice, and the provision of dispute resolution schemes.

In many areas, there is no clear dividing line between market integrity and consumer protection regulation, particularly as both involve the same regulatory tools, namely disclosure and conduct rules.

Consumer protection is focused on retail markets because retail consumers of financial services often lack sufficient knowledge, experience or judgment to decide what information they need. They also require greater protection than do other users of financial services. Conversely, financially sophisticated participants in wholesale markets can reasonably be expected to attend to their own informational needs. The objective of regulating wholesale markets is therefore limited to ensuring that market infrastructure is sound and that markets are free from abuses.[3]

This chapter is presented in two sections:

- Section 7.2 discusses the appropriate organisational framework for market integrity and consumer protection regulation in the finance sector; and
- Section 7.3 discusses proposed reforms to the approach to, and design of, regulation that could improve the efficiency and effectiveness of such regulation within the overall framework.

3 In practice, the distinction between retail and wholesale is imprecise and may vary between markets (see Section 7.2.4).

7.2 The Regulatory Framework

7.2.1 Current Arrangements

Several Commonwealth agencies provide specific forms of market integrity and consumer protection regulation for savings, investment, risk management and payment products, and the provision of advice. Each operates within a unique framework in different and sometimes overlapping segments of the financial system.

Responsibility for market integrity and consumer regulation of financial services is shared among the following organisations:

- the Insurance and Superannuation Commission (ISC) in relation to life insurance, general insurance and superannuation products, and insurance brokers;
- the Australian Securities Commission (ASC) in relation to securities dealers, investment advisers, futures brokers and advisers, collective investment schemes and debentures;
- the Australian Competition and Consumer Commission (ACCC) in relation to economy wide business conduct laws and price monitoring; and
- the Australian Payments System Council (APSC), an advisory body reporting to the Treasurer and chaired by the Reserve Bank of Australia (RBA), which monitors industry codes of practice for electronic funds transfer schemes, banks, building societies and credit unions.

Regulation of credit is the responsibility of the States and Territories under the *Uniform Consumer Credit Code* (UCCC) which commenced operation on 1 November 1996. Like the areas of specific regulation provided by Commonwealth financial regulators, the UCCC provides specific regulation in a field which is also broadly covered by the *Trade Practices Act 1974*.

7.2.2 Key Issues

The Inquiry received many submissions expressing dissatisfaction with the existing framework for the delivery of market integrity and, more particularly, consumer protection regulation in the finance sector. These concerns were set out in some detail in the Inquiry's Discussion Paper but can be summarised as follows:

- concern that the existing Commonwealth arrangements for specific conduct and disclosure regulation produce inconsistencies in a number of areas due to the institutional basis of financial regulation, with gaps, overlaps, and unevenness in regulatory intensity, style and cost;
- concern over areas of duplication between the specific conduct and disclosure regulation for the financial system provided by financial regulators and the general, economy wide regulation provided by the ACCC under the Trade Practices Act; and
- in the case of credit regulation, concern expressed by industry that the UCCC suffers from slow or inefficient review and amendment processes, continuing areas of non-uniformity and inadequate attention to cost effectiveness.

In response to these concerns, a variety of proposals were put forward for reform of the framework, and the Inquiry set out in its Discussion Paper a number of these models for reform. These included:

- **Dual Regulatory Model** — combining specific finance sector regulation in a single agency while retaining the concurrent general application of the Trade Practices Act to the finance sector;
- **Coregulatory Model** — providing for industry based self-regulatory codes overseen both by a financial system self-regulatory organisation and by a small statutory consumer regulator, together with continued general application of the Trade Practices Act; and
- **Single Regulator Model** — replacing all existing specific and general conduct and disclosure regulation of the financial system by a single, dedicated financial system regulator.

7.2.3 The Inquiry's Model

In this section, the Inquiry reviews the various issues and options and proposes its model for the overall framework of market integrity and consumer protection regulation.

In considering the options, the Inquiry addressed four key questions.

- Is there sufficient advantage, relative to the costs of change, to warrant bringing together into one agency all areas of specific finance sector consumer protection regulation currently undertaken by the various Commonwealth financial regulators?
- If so, should that Commonwealth agency be a stand-alone consumer protection agency or should it also be the same agency responsible for regulation of market integrity, securities and corporations?
- How can the costs and benefits of dual coverage by the specific and general market regulators best be reconciled?
- Would there be net advantage in transferring the regulation of credit from the States and Territories to the Commonwealth?

The following sections provide the Inquiry's views on each of these questions. In summary, the Inquiry found most of the claims made against the existing arrangements persuasive and believes that there is a need to rationalise existing arrangements in a number of ways.

The Inquiry sought to balance the competing considerations in this area by proposing a model which combines the best features of the options set out in the Discussion Paper. The key features of the model are:

- combining all existing specific Commonwealth consumer protection regulation under a single agency to achieve greater consistency and flexibility of regulation;
- combining in one agency responsibility for market integrity, corporations, and consumer protection regulation in recognition of the close links, imprecise boundaries and inevitable overlaps between these forms of regulation;

- dealing with the inconsistencies between the due diligence provisions provided under specific corporations and superannuation laws and the consumer protection provisions of the Trade Practices Act; and
- at least at this time, leaving jurisdiction for the credit laws with the States and Territories to provide a longer period of assessment of the UCCC and to focus efforts on improving its cost effectiveness.

These conclusions are discussed in more detail in the remainder of Section 7.2. The role of coregulation, also raised in the Discussion Paper, relates to the approach to regulation and is addressed in Section 7.3.

7.2.4 Specific Commonwealth Regulation of Conduct and Disclosure

The key issues for the Inquiry in considering the Commonwealth's existing roles in providing conduct and disclosure regulation specific to the finance sector are:

- whether the arrangements for the regulation of market integrity and consumer protection should be conducted on a functional or institutional basis;[4] and
- whether market integrity (and corporations) regulation and consumer protection should be undertaken by the same regulator.

Functional Approach to Regulation

Market integrity regulation is currently conducted on a functional basis, with responsibility vested in one regulator, the ASC. In contrast, consumer protection in the finance sector is currently conducted in varying degrees by three Commonwealth regulators, the agency responsible depending on the type of institution offering the product or service (outlined in Section 7.2.1).

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4 According to Merton & Bodie 1995, functional regulation treats all providers of functionally equivalent products or services equivalently, whereas institutional regulation treats all similar institutions similarly.

Compelling reasons were presented to the Inquiry for amalgamating in one regulator the existing Commonwealth consumer protection arrangements for the financial system. The negative consequences of the present fragmented arrangements were seen to include:

- substantially differing disclosure requirements for similar investment vehicles (eg public unit trusts and investment linked life policies); and
- inconsistent approaches to the regulation of financial sales and advice for securities brokers and life insurance agents and brokers.

Beyond these criticisms, the more general observation is that the forces shaping financial markets impose pressure on regulators to be flexible and even handed in the way they respond to new financial products, new modes of financial service delivery, new entrants into the financial services industry and changes in the mix of financial products offered by institutions. As noted in Chapter 4, these forces will continue to drive changes in the financial system and will increasingly blur distinctions between end users and financial institutions.

Maintaining several specialised consumer protection regulators is unlikely to facilitate responsiveness to these changes. Moreover, it results in financial service providers having to deal with several regulators and creates confusion for customers seeking to understand and compare substitutable products (often offered by the same financial group) or seeking redress when problems arise. It also requires regulatory agencies whose primary focus is prudential regulation to maintain expertise and powers in the quite different field of consumer protection.

The Inquiry considers that better focused, more consistent and responsive regulation would be delivered by a single regulator covering the whole finance sector. This suggests amalgamating within one regulator the current consumer protection roles of the ASC, ISC and APSC.

Single Market Integrity and Consumer Protection Regulator

Market integrity and consumer protection are closely linked. They both aim to enhance investor confidence in the operation of financial markets and financial service providers and often using similar tools. For example, licensing of securities dealers aims both to protect consumers from unscrupulous or incompetent operators and to ensure that securities markets operate efficiently.

The extent of regulation required for wholesale markets is less than for retail markets. However, it is not always straightforward in practice to differentiate between retail and wholesale markets. Pragmatic approaches need to be adopted to ensure that the regulatory framework is flexible enough to cope with shifts and imprecision in the dividing line. Any separation of regulation of market integrity and consumer protection would create considerable difficulties in defining boundaries and result in market participants engaged in both wholesale and retail transactions being subject to two regulators covering similar functions. The ASC is currently performing both of these functions within the coverage of its jurisdiction and the Inquiry did not receive compelling evidence to suggest that these functions would be better carried out separately.

There are also strong links between financial market integrity regulation and general corporations regulation. Existing regulation of corporations which aims to promote disclosure to public investors of the nature of investments in corporations on offer relies heavily on principles of good corporate governance. In addition, the financial markets are an important source and facilitator of corporate finance. The functions of regulating companies, corporate finance and financial markets are currently performed in Australia by a single regulator (the ASC) and appear to be working reasonably well. In contrast, separation of the functions in some other countries is generally considered to present coordination and other problems.

A number of submissions to the Inquiry argued for the creation of a separate specialist consumer protection regulator because of the concern that consumer protection would otherwise become subservient to other objectives. However, this risk is more likely to arise where consumer protection is combined with the functionally different task of prudential regulation. The tasks of consumer protection, market integrity and corporations regulation are more complementary than conflicting.

The Inquiry also considers that there is merit in establishing an agency which has a broader task than consumer protection in isolation to ensure that there is a balance of perspective in pursuing regulatory objectives.

For these reasons, the Inquiry considers that the regulation of financial market integrity and consumer protection in the finance sector should be carried out together. The single agency established for these purposes should have essentially the same conduct and disclosure regulation functions as are presently vested in the existing agencies (subject to the changes in powers and regulatory approaches recommended here and in Section 7.3).

Recommendation 1: Corporations Law, market integrity and consumer protection should be combined in a single agency.

A single agency, the Corporations and Financial Services Commission (CFSC), should be established to provide Commonwealth regulation of corporations, financial market integrity and consumer protection. It should combine the existing market integrity, corporations and consumer protection roles of the Australian Securities Commission (ASC), the Insurance and Superannuation Commission (ISC) and the Australian Payments System Council.

Recommendation 2: The CFSC should have comprehensive responsibilities.

The CFSC should be responsible for:

- financial market integrity, including:
  - regulating disclosure for securities and retail investment products;
  - regulating market conduct to promote orderly and efficient price discovery, trading and settlement;
  - determining applications for new exchanges, and overseeing the activities of existing exchanges;

  - regulating investment and insurance sales and advice and financial market dealers and participants;
  - regulating compliance of collective investment schemes;
  - facilitating the development of new markets for debt and equity instruments;
  - monitoring financial innovation and technological developments in the provision of financial products and services and determining appropriate regulatory responses;
- regulation of corporations, including incorporation, governance, insolvency and liquidation, and takeovers; and
- finance sector consumer protection regulation, including:
  - regulating the conduct of dealings with consumers and the prevention of fraud;
  - approving and overseeing industry codes of conduct, codes of conduct for new payments technologies and dispute resolution arrangements;
  - delegating accreditation and disciplinary functions to self-regulatory bodies where appropriate; and
  - setting benchmarks for and monitoring the performance of those self-regulatory bodies.

7.2.5 Avoiding Overlap Between Specific and Economy Wide Regulation

This section deals with three distinct but interlinked issues:

- the ACCC's general role in relation to conduct and disclosure regulation in the finance sector;
- the overlap between the Trade Practices Act and the Corporations Law in their application to liability for misleading statements in, or omissions from, prospectuses and other documents required by the Corporations Law; and

- the arrangements for examining the rules of financial exchanges.

Conduct and Disclosure

At present the ACCC is responsible for ensuring compliance with the consumer protection provisions in Parts IVA and V of the Trade Practices Act, in particular s. 52 which prohibits corporations from engaging in misleading or deceptive conduct. Its responsibility in this respect extends economy wide.

The common argument in favour of retaining the economy wide (or universal) regulator's role is the risk that a specialist regulator may develop a shared interest in the industry being regulated ('regulatory capture'). According to this view, 'framework legislation' which sets out the minimum standards for adequately functioning markets is most effective where it applies across the whole economy and is enforced by an independent agency.

As noted in Chapter 5, the particular characteristics of the financial system suggest that there is a case for providing it with specific regulatory arrangements for financial market integrity and consumer protection. To be effective, the CFSC needs comprehensive powers to take appropriate actions wherever problems occur in the financial system. It is important that the CFSC's responsibility, and its accountability to government for discharging that responsibility, be broad and unambiguous.

The coexistence of the ACCC's and CFSC's roles creates potential for regulatory duplication in the financial system. Dual administration of regulation should be avoided as it generates additional compliance costs, uncertainty and the risk of inconsistency.

The Committee accepts that the substantive consumer protection provisions of the Trade Practices Act should apply to the financial system. However, it does not follow that the ACCC should administer these provisions in relation to the financial system once the CFSC is established. Such a role would detract from the responsibility of the CFSC for consumer protection within the finance sector. Given the wide reach of responsibilities proposed for the CFSC, the Inquiry does not consider that the risks of regulatory capture of the CFSC are substantial.

The Inquiry considers that the best course is to include within the CFSC's legislation provisions comparable to the consumer protection provisions of the Trade Practices Act. The CFSC should be the regulatory agency that takes any necessary action under these provisions in its area of responsibility for the financial system. The field for which the CFSC is to be responsible will need to be clearly defined.[5]

This would not require the ACCC's jurisdiction over those areas to be formally withdrawn. Indeed, maintaining its jurisdiction would remove any risk of a regulatory gap emerging. The ACCC and CFSC should enter into an operating agreement to eliminate duplication of enforcement effort. If necessary, the Treasurer could give the ACCC a direction under s. 29 of the Trade Practices Act to make its role clear and to avoid any gaps in coverage due to convergence between the financial system and other industries.[6]

Recommendation 3: The CFSC should administer all consumer protection laws for financial services.

While the economy wide reach of the powers of the Australian Competition and Consumer Commission (ACCC) should be retained in law (subject to Recommendation 4), the CFSC should have sole responsibility for administering consumer protection regulation within its jurisdiction over the finance sector. For this purpose, consumer protection provisions comparable to those in the *Trade Practices Act 1974* should be included in the CFSC's legislation.

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5 It should include all types of business offering banking and deposit products, insurance (risk) products, superannuation, investment products, and advisory services connected with them. It should exclude the provision of credit since this is regulated at the State/Territory level.

6 Section 29 of the Trade Practices Act provides that the Minister may give the ACCC a direction about the administration of the Act. The direction must be published in the Commonwealth Gazette.

Prospectuses and Other Documents

Section 1022 of the Corporations Law requires a person offering securities for sale or subscription to issue a prospectus which contains information sufficient to enable a prospective investor to make an informed investment decision. False or misleading statements or omissions are prohibited. People who suffer loss as a result of a misleading statement or omission may generally recover that loss from those responsible for issuing the prospectus. However, there is a defence to liability if reasonable precautions were taken and due diligence exercised to ensure that all material information was included in the prospectus and that all the statements made were accurate.[7] This defence is generally referred to as the 'due diligence defence'. The Government has announced its intention to introduce similar provisions into the *Life Insurance Act 1995*.[8]

Similarly, the takeover provisions of the Corporations Law require a person making a takeover offer to disclose certain information. These provisions are underpinned by civil liability provisions if the disclosure is misleading. A defence is provided if reasonable precautions were taken.[9]

The *Superannuation Industry (Supervision) Act 1993* (SIS Act) contains similar provisions requiring a trustee of a public offer superannuation fund to disclose information about the fund. It also provides for liability for misleading statements or omissions, and a due diligence defence. [10]

Section 52 of the Trade Practices Act is a general provision prohibiting misleading and deceptive conduct in trade or commerce and s. 82 provides a right of action for a person who suffers loss or damage as a result. The Trade Practices Act does not impose a duty to disclose, and no due diligence defence is available for misstatements or omissions.[11] Similarly, s. 995 of the Corporations Law is a general prohibition against misleading or deceptive conduct and it is unclear whether the due diligence defence applies. Table 7.1 summarises the effect of the current legislation.

7 See ss. 1008A(4), 1009(3), & 1011(1) of the Corporations Law.

8 Kemp 1996.

9 See ss. 704(6) & 704(8) of the Corporations Law.

10 See ss. 162 & 323 of the *Superannuation Industry (Supervision) Act 1993*.

Prospectuses, Superannuation and Takeovers are Subject to Overlapping Legislation . . .

Table 7.1: Overlaps among s. 52 Trade Practices Act 1974, Corporations Law and Superannuation Industry (Supervision) Act 1993.

	Trade Practices	Corporations Law			SIS
	s. 52	s. 995	Prospectus s. 996 s. 1022	Takeovers s. 704 s. 705 s. 750	s. 157 s. 162 s. 323
Disclosure					
All material information			✓	✓	✓
Basis for liability					
Misleading and deceptive conduct	✓	✓			
False or misleading statements or omissions			✓	✓	✓
Remedies					
Damages	✓	✓	✓	✓	✓
Injunctions	✓	✓	✓	✓	✓
Criminal			✓	✓	✓
Defences					
to actions for damages			✓	✓	✓
to actions for injunction					
to criminal actions			✓	✓	✓

Source: Derived from Corporations Law Simplification Task Force 1996, *Section 52 Trade Practices Act and Dealings in Securities*.

11 Similar provisions are contained in State and Territory fair trading laws administered by State based consumer affairs authorities.

The differences between these regimes creates an uncertain environment for fundraising by corporations and disclosure by trustees. Many believe it also results in the provision of unnecessarily detailed prospectuses. It is important to resolve this uncertainty and to encourage shorter prospectuses.[12]

The provisions of the Corporations Law require positive disclosure and provide tailored defences. The balance between disclosure, liability and defences has been carefully struck, and is consistent with provisions governing securities issues and takeovers in the United Kingdom, the United States, Canada and New Zealand. Similar considerations apply to the disclosure required of trustees of public offer superannuation funds under the SIS Act, and proposed disclosure requirements under the Life Insurance Act.

The provisions in the Trade Practices Act apply generally and were not constructed in the context of provisions which require positive disclosure.

Unlike the consumption of products or services in general, many investments provide a return to investors based on their bearing a share of the risks which are intrinsic to financial activity. This clearly distinguishes the act of investment from the act of consumption. Among the risks that investors may be rewarded for bearing are those deriving from imperfect information. It is vital to economic efficiency that regulation not unduly interfere with this risk allocation function of the financial system. In the areas of the law which have provided specific due diligence defences, explicit balances have been struck between consumer protection and market efficiency objectives, and these should not be interfered with by other laws.

The Inquiry considers that conduct in fundraising and takeovers, in respect of which the Corporations Law imposes a positive duty to disclose certain

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12 The Corporations Law Simplification Task Force has been asked to report on the application of s. 52 of the Trade Practices Act to fundraising and other dealings in securities. In March 1997, the Treasurer released the task force report which discussed the overlap between the two regimes and options for dealing with it. It recommended that conduct in relation to fundraising, takeovers and other dealings in securities be governed by the Corporations Law and not by the provisions in Part V of the Trade Practices Act. See Corporations Law Simplification Task Force 1996, *Section 52 Trade Practices Act and Dealings in Securities*.

information, should carry the defences available under the Corporations Law regime. Therefore, it should be made absolutely clear that the liability regimes in the Corporations Law and SIS Act, including the due diligence defences, apply to prospectuses, takeover documents and superannuation statements. This could be achieved by:

- providing that, in any action brought under s. 52 or comparable legislation in relation to a statement contained in or omitted from a prospectus, takeover document or superannuation statement, a due diligence defence should apply; or
- excluding from the application of s. 52, and comparable legislation, actions concerning statements contained in or omitted from a prospectus, takeover document or superannuation statement.

The overlap between s. 995 and s. 996 of the Corporations Law raises similar issues and should also be removed.

Recommendation 4: Due diligence defences should apply to positive disclosure requirements.

The due diligence defences associated with a positive duty to disclose such as under the *Corporations Law* and the *Superannuation Industry (Supervision) Act 1993* should have full effect, notwithstanding s. 995 of the *Corporations Law* and s. 52 of the *Trade Practices Act 1974*.

Financial Exchange Rules

The business and listing rules of financial exchanges are examined:

- in all cases, by the ASC which advises the Treasurer on whether they should be disallowed on market integrity grounds; and
- where the rules may constitute an anti-competitive arrangement, by the ACCC which has power to authorise anti-competitive arrangements under s. 88 of the Trade Practices Act.

The Australian Stock Exchange (ASX) indicated to the Inquiry that it had encountered some delays as a result of this dual supervision. The issue arises whether the ACCC or the proposed CFSC should be solely responsible for oversight of exchange rules to accelerate the process.

For the reasons explained in Chapter 10, the Inquiry believes that the ACCC should be retained as the economy wide competition regulator. It should retain responsibility for scrutinising markets for anti-competitive conduct. The Inquiry considers that disallowance under the Corporations Law (for market integrity purposes) and authorisation under the Trade Practices Act (for competition policy purposes) serve distinct functions and require different skills on the part of the regulators. Therefore, the potential dual scrutiny of financial market rules by the CFSC and the ACCC should be retained. However, the CFSC and ACCC should take action to provide faster and more coordinated processes for the scrutiny of these rules.

A related issue is whether the Treasurer should retain responsibility for formally disallowing changes to the rules of an exchange for market integrity reasons. In the Inquiry's view, it is appropriate that this power be conferred on the CFSC. Many rule changes involve technical issues which do not warrant the Treasurer's attention, and to require it would slow the approval process. As the CFSC is to be responsible for market integrity regulation, it should have all the powers necessary to discharge that function.

Recommendation 5: The CFSC and the ACCC should coordinate examination of financial exchange rules.

To improve the administration of the law relating to the rules of financial exchanges:

- financial exchange business and listing rules should be subject to disallowance on market integrity grounds by the CFSC rather than the Treasurer;
- the ACCC should continue to be responsible for authorising financial exchange rules and arrangements under s. 88 of the *Trade Practices Act 1974*; and

- the CFSC and ACCC should coordinate and accelerate their consideration of these rules.

7.2.6 State and Territory Credit Regulation

This section discusses the existing consumer protection roles of the States and Territories in relation to the financial system. The main State/Territory consumer protection legislation which affects the finance sector is the consumer credit legislation.

Until recently, consumer credit legislation in force throughout Australia was far from uniform. This lack of uniformity raised the cost of compliance for credit providers operating across State and Territory borders. In addition, the legislation in most States and Territories had been criticised as outdated, overly prescriptive and covering only a small portion of the consumer credit market (predominantly loans up to $20,000 excluding overdrafts).

After lengthy negotiation, the UCCC was introduced in most Australian States and Territories on 1 November 1996. In Tasmania, the new scheme did not apply to some providers until March 1997.

The UCCC governs precontractual disclosure requirements. It contains a range of sanctions which may be applied where a credit provider fails to comply (such as civil and criminal penalties, compensation to the consumer and setting aside of relevant contractual and security provisions).

Criticisms of the UCCC

Many credit providers operate nationally. From that perspective, the current regulatory structure does not provide the most efficient regulation.

The scheme was developed under the intergovernmental Uniform Credit Laws Agreement 1993. The agreement expressly acknowledged that there should be uniformity both in consumer credit laws and in their administration in the States and Territories. However, in allowing for the implementation of 'alternative consistent legislation', the agreement permits a measure of departure from the principle of uniformity. The Western Australian and Tasmanian codes differ from the template legislation in a number of respects.

Areas of non-uniformity under the UCCC agreed to by the States and Territories include those relating to whether:

- courts or tribunals are to be vested with jurisdiction in respect of disputes under the UCCC;
- a maximum interest rate in respect of consumer credit contracts is to be set; and
- there is to be any scheme for the registration or licensing of credit providers.[13]

In addition, non-uniformity may arise from the following factors:

- the agreement allows any party to withdraw from the scheme at any time by notice to the Ministerial Council of Consumer Affairs (MCCA);
- the existence of different adjudicative systems could result in inconsistency in the interpretation of the UCCC; and
- the number of parties to the agreement and the basis upon which any amendment must be agreed are likely to delay any amendments to the UCCC.[14]

Apart from non-uniformity, further features of the UCCC which have been criticised are:

- the penalties regime, which could stifle innovation as more innovative products are likely to require more complex disclosure;
- the prescriptive disclosure requirements, which result in an increase in the length of documents;
- the excessive number of copies of contracts required to be supplied to debtors and guarantors; and

13 Information provided to the Inquiry by Blake Dawson Waldron.

14 Amendments to the laws require the approval of the Ministerial Council of Consumer Affairs.

- the contract reopening provisions which potentially weaken agreed market outcomes.

As the UCCC has only existed since November 1996, the Inquiry did not examine these concerns in great detail. Five months is an unduly short period on which to base an assessment of its effectiveness. In view of non-uniformity and other criticisms, the Inquiry considered whether there would be net benefits in transferring the UCCC to the Commonwealth.

There are advantages in having credit laws administered together with other State and Territory consumer protection laws, particularly fair trading laws.

- First, four States and the ACT have established specialist tribunals to determine disputes arising under the UCCC and all have deployed resources in administering these laws. Transferring this responsibility to the Commonwealth would require the Commonwealth to establish its own specialised tribunals (duplicating already incurred costs) or to provide cross-vesting powers to the existing tribunals (which would largely defeat the purpose of the transfer).
- Secondly, consumers have greater difficulty making informed decisions about credit where the transaction occurs concurrently with the purchase of another product or service. A credit dispute is therefore often linked to a dispute over the purchase of a consumer product governed by State law.
- Thirdly, the States and Territories have developed considerable expertise in credit matters through developing and administering the UCCC. To date the Commonwealth has played a limited role in the development of the UCCC.[15]

There is already a process in place to address many of the issues and concerns about the UCCC. The MCCA called for and received submissions from all industry and consumer interests. These are being analysed for transmission to Parliamentary Counsel to draft necessary amendments.[16] For the next 12 to 18 months, the UCCC is to be monitored by the Uniform

15 Ministerial Council of Consumer Affairs, Supplementary Submission No. 62, p. 1.
16 Ministerial Council of Consumer Affairs, Supplementary Submission No. 62, p. 2.

Consumer Credit Code Management Committee. In 1996, the MCCA twice redressed practical problems arising under the UCCC. In particular, problems raised by the Australian Securitisation Forum were addressed in part by special regulations made shortly before the UCCC commenced operation.

It is highly desirable that these processes continue and that the responsible authorities focus their attention on making the UCCC less costly for credit providers and more effective for consumers rather than on the complex issues that would arise in any transfer or sharing of jurisdiction.

While the Inquiry has sympathy with calls to shift the jurisdiction of credit laws to the Commonwealth, it considers that the UCCC has not been in operation for a sufficient period to establish whether the criticisms of the Code and the processes for its amendment are justified.

However, given the depth of concern expressed by industry participants and associations about aspects of the UCCC, there would be merit in conducting a comprehensive and independent review after the UCCC has been in force for a reasonable period. Two years of operation should provide sufficient experience for a proper review. The review should consider whether problems identified could be remedied by a transfer to Commonwealth jurisdiction.

Recommendation 6: States and Territories should retain and review consumer credit laws.

The States and Territories should retain responsibility for the *Uniform Consumer Credit Code* (UCCC) and related laws and focus efforts on improving its cost effectiveness and nation wide uniformity. After it has operated for two years, the UCCC should be subject to a comprehensive and independent review to consider what improvements are necessary and whether a transfer to the Commonwealth would be appropriate.

7.3 Approach to Regulation

The Inquiry is concerned to simplify and reduce the cost of market integrity and consumer protection regulation, and to improve its effectiveness. This would benefit consumers directly as well as increase the international competitiveness of the Australian financial system. This section reviews the following key areas:

- overall approach to regulation;
- disclosure regulation;
- regulation of financial market participants;
- regulation of financial markets and instruments;
- Corporations Law;
- complaints handling and dispute resolution; and
- regulatory effectiveness.

7.3.1 Overall Approach to Regulation

A wide variety of views were put to the Inquiry concerning the approach to regulation that would best balance the objectives of efficiency and effectiveness. The main options are:

- **a statutory approach** — where specific and detailed laws are enacted and administered by a regulatory agency;
- **a coregulatory approach** — where 'framework legislation' sets out general principles for market conduct and consumer protection and the specific regulation of transactions is provided through codes in particular industries;[17] and
- **a self-regulatory approach** — where there is no specific legislative backing to schemes administered by industry groups.

17 This approach is consistent with the notion of responsive regulations described by Ayres & Braithwaite 1992, by which 'public policy can effectively delegate government regulation of the marketplace to public interest groups'. Central to this is the theme that forms of government intervention will reinforce less intrusive delegated forms of self-regulation.

Each of these approaches has its own advantages and each is appropriate in particular circumstances.

A statutory approach enables a greater degree of consistency to be applied across industry sectors. It is more effective than coregulation in industries which are highly dispersed or have a history of market conduct and disclosure problems. However, prescriptive legislation is more difficult to change to reflect market developments.

Coregulation works best where there are established industry associations covering all industry participants, with the willingness and resources to monitor, enforce and publicise regulations. This approach is more responsive to market developments as codes, rather than laws, are more readily modified to reflect developments in the market. It also places the cost of regulation directly on businesses and consumers who benefit from it rather than on general taxpayers.

However, coregulation is more susceptible to regulatory capture as it relies more heavily on industry. It results in more disjointed regulation as it is inevitably applied by institutionally based industry self-regulatory organisations (SROs). If SROs were created across the whole financial system, coregulation would result in conglomerates facing multiple self-regulatory organisations.[18]

Coregulation already exists to varying degrees in the financial system. For instance, in the financial markets, the ASX and Sydney Futures Exchange (SFE) perform essential regulatory roles. Other groups are increasingly taking up coregulatory roles.[19]

The retail markets generally are less suited to coregulation than are wholesale markets because of greater information imbalances between consumers and suppliers. However, various industry codes of conduct covering retail financial services currently exist.

18 Under the UK's self-regulatory structure, there are 22 individual self-regulatory organisations.

19 The Australian Financial Markets Association is one such group.

Given the special characteristics of the financial system (as outlined in Chapter 5), self-regulation is likely to be appropriate in limited circumstances.

The Inquiry considers that the best way to achieve cost-effective conduct and disclosure regulation is to use a combination of regulatory approaches. This may be achieved by vesting the CFSC with broad framework legislation. In addition, it should have the power to adopt detailed codes which prescribe appropriate conduct in particular industries, or to leave it to industry to develop such codes. Given these broad powers, the CFSC would have the discretion to decide the appropriate approach to regulation to be used in particular circumstances.

The ACCC recommended that the finance industry play a more prominent self-regulatory role in transactions regulation to protect consumers, and that the specialist regulators gradually reduce their roles. It proposed a formalised coregulatory framework involving the creation of an umbrella self-regulatory body with coverage of all aspects of consumer protection in the financial system. A small statutory body would be responsible for auditing the self-regulatory body and advising the Treasurer on relevant policy implications.[20]

While, as discussed above, the Inquiry sees merit in a coregulatory approach in particular circumstances, it does not consider it possible to rely on this approach across the board. The areas of market integrity and consumer protection which would be suitable for further self-regulation are matters for the CFSC to decide case by case.

Recommendation 7: The CFSC should have powers to use a combination of regulatory approaches.

In addition to its framework legislation, the CFSC should have the power to adopt detailed codes which prescribe appropriate conduct and disclosure in particular industries or to allow the industry to develop such codes. Given

20 Australian Competition and Consumer Commission, Submission No. 181. Parts of the proposed coregulatory scheme would be subject to authorisation by the ACCC.

these broad powers, the CFSC would have the discretion to decide the best approach to regulation to be used in particular circumstances.

The CFSC should have an explicit mandate to balance the efficiency and effectiveness of its regulatory approaches.

7.3.2 Disclosure Regulation

The measure of effective disclosure is its ability to inform the decisions of customers.

Disclosure regulation is at the core of any scheme to protect consumers as it allows them to exercise informed choice. However, it is the quality and usefulness of information which are important, not its quantity. Excessive or complex information can be counterproductive as it may confuse consumers and discourage them from using disclosure documents. Complex disclosure requirements also increase industry's compliance costs which are ultimately borne by consumers.

The aim of regulation should be effective disclosure, not merely the production of information.

The following reviews three areas of disclosure:

- the general approach;
- prospectus provisions; and
- financial reporting.

General Approach

Financial market participants currently face a range of information disclosure rules which vary greatly in their status, degree of prescription and penalties for breach.

- The Corporations Law requires a prospectus for the issue or sale of securities or collective investments and carries civil and criminal penalties for breaches.

- For some insurance and superannuation products, the ISC has issued circulars prescribing in detail the information suppliers must disclose. These circulars complement general legislative requirements to disclose all relevant information but do not currently have a statutory basis in themselves, and therefore do not carry civil or criminal liability for breaches.[21]
- For banking products provided by banks and non-bank financial institutions, the industry has developed a number of codes of conduct which set out disclosure requirements. The codes are implied into banking contracts as a contractual condition but no specific civil or criminal liability exists.

These requirements aim to address an information imbalance between suppliers and purchasers of financial products and services. They are therefore structured for the most part so that they do not apply to circumstances in which investors can reasonably be expected to obtain needed information themselves. This is typically the case where the prospective purchaser is a professional investor or wholesale participant.[22]

The Inquiry received many submissions about the volume of information suppliers must provide to retail purchasers about financial services and products. It appears that the information disclosed to retail purchasers is too voluminous and legalistic in many cases to serve its purpose.

There are also widespread concerns that the information available does not allow prospective purchasers to compare products. This difficulty is exacerbated by the great range of financial products on offer and their varying taxation treatment. Consumers need to compare product characteristics, costs and expected rates of return if they are to make informed decisions. Disclosure statements need to be framed to make comparison possible.

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21 Note, however, that civil or criminal liability may apply to a breach of the underlying legislation. See, for example, ss. 161 and 162 of the *SIS Act* which impose civil and criminal liability for false or misleading statements or omissions about public offer superannuation funds.

22 For example, the general prospectus requirements do not apply to individual issues of securities over $500,000 in value: see s. 66(2)(a) of the Corporations Law. This exclusion is aimed at sophisticated investors who are considered to have sufficient resources and bargaining power to evaluate investments without a formal prospectus.

The Inquiry also believes that consumers need information about fees, commissions (including trailing commissions) and the remuneration paid to their financial advisers or brokers so that they can determine whether a recommendation is skewed in favour of a particular product.

Under current regulations, investment advisers, life agents and brokers are required to disclose in detail the fees or commissions they earn on particular products. These requirements do not apply to all people who may give advice, such as bank staff. The Inquiry considers that disclosure of remuneration should be made at a minimum in relation to products for which commissions are deducted from the consumer's investment (eg insurance, investment policies and unit trust investments).

Concentrating regulatory oversight of disclosure requirements in a single regulator should improve their effectiveness. Existing disclosure requirements, however imposed, should therefore be reviewed by the CFSC. If necessary, they should be recast to ensure that the information provided is:

- comprehensible and relevant to consumers; and
- consistent with and comparable to that for similar and substitute products, such as market linked life company products, collective investments and public offer superannuation products.

The CFSC would need powers to require positive disclosure for all retail financial products defined broadly to include deposit accounts, payments instruments, securities, collective investments, superannuation and insurance products. However, in certain cases it may decide not to exercise these powers. For example, deposit taking institutions (DTIs) continue to be subject to less onerous financial disclosure requirements for deposit taking than those for other fund raisings given that they are subject to more intensive prudential supervision than other providers of financial services. While DTIs are not required to provide a prospectus for deposit taking, they are subject to product disclosure requirements under various codes of conduct.

As banks and non-bank financial institutions offer functionally similar deposit and transaction products, the codes of conduct applying to banks, building societies and credit unions should be made consistent where possible.

The effectiveness of the disclosure requirements should be monitored; for example, by using consumer surveys or focus groups, or by measuring complaints arising from consumers misunderstanding the information provided.

Recommendation 8: Disclosure requirements should be consistent and comparable.

Disclosure requirements for retail financial products (deposit accounts, payments instruments, securities, collective investments, superannuation and insurance products) should be reviewed by the CFSC to ensure they provide information that enables comparison between products. This information should:

- be comprehensible and sufficient to enable a consumer to make an informed decision relating to the financial product;
- be consistent with that for similar products regardless of which institution offers them; and
- appropriately disclose remuneration or commissions paid to advisers.

The disclosure codes of conduct applying to banking, building societies and credit unions should be made consistent wherever possible.

The effectiveness of disclosure requirements should be monitored regularly, using complaints data and user testing.

Prospectus Provisions

Part 7.12 of the Corporations Law generally requires the issue of a prospectus for offers of securities and collective investments. Two projects reviewing prospectus requirements are the Collective Investments Review (currently before Government) and a review by the Corporations Law Simplification Task Force.

Considerable concern remains about the level and nature of disclosure in prospectuses. Out of an abundance of caution, many contain much information of little use to investors. Excessive costs and time consuming due diligence defence procedures have resulted from a desire to limit the civil liability of promoters for misstatements or omissions.

The approach encapsulated in s. 1022 of the Corporations Law places the onus on the issuer to include all information that a reasonable investor would expect in order to make an informed investment decision. The Inquiry believes that this approach is desirable. It is flexible and places responsibility for the content of a prospectus squarely on the issuer which is in the best position to judge the information needed by investors to make an informed investment decision.

The Inquiry also endorses the approach taken in Part 7.11 of the Corporations Law to impose civil liability for false or misleading statements or omissions. This approach is consistent with that adopted in the regulation of superannuation and insurance products.[23]

The following discussion suggests means for improving the cost effectiveness of prospectus provisions through the use of short form profile statement and shorter prospectuses.

Profile Statements

Some prospectuses do not inform investors adequately about the nature of the product on offer. The Inquiry believes that the law should be amended to require the issue of a profile statement for retail investment products.

Key features statements are currently required under ISC Life Insurance Circular G.I.1 and a SIS Determination for some life company and superannuation products. The Committee understands that these have been

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23 ISC 1996, *A Guide to the Insurance Contracts* and see s. 162 of the *SIS Act*, Regulation 2.10(2) of the Superannuation Industry (Supervision) Regulations, and s. 13 of the *Insurance Contracts Act 1984.*

successful in providing consumers with information about those products, especially about fees, charges and commissions payable. However, there has been some criticism of the amount of detailed prescription under these statements. The Inquiry believes that the short-form profile statement should be brief and should be developed for application to the full range of offers of retail investment products.

For all retail investment products other than primary issues of securities by corporations, the profile statement should include:

- a brief description of the characteristics of the product, such as whether it is a long-term or short-term investment, and whether it offers capital growth or an income stream;
- an unambiguous statement of the risks involved;
- an unambiguous statement of fees, commissions and charges, in a form which enables comparison with similar products; and
- such other disclosures for specific products as the CFSC considers appropriate.

For primary issues of securities by corporations, the profile statement should contain an outline of the nature of the investment, the standard charges for purchasing and selling the securities, and the risks involved in the investment. (A statement would not be required in circumstances where a prospectus was not required, such as an issue of securities to a professional investor.)

Beyond this, the contents of the profile statement should not be prescribed by regulation, unless the CFSC believes that prescription is required to ensure a balanced representation of the product.

The issue of a profile statement in respect of securities or collective investments would not relieve the issuer of the need to prepare and lodge a full prospectus as required by s. 1022 of the Corporations Law. However, it would allow an issuer to prepare a more succinct and comprehensible document for consumers in a format of the issuer's choosing. Investors should be entitled to invest on the basis of the profile statement without viewing the full prospectus.

The terms of the offer would be as set out in the full prospectus (for securities, superannuation or other collective investments) or insurance contract (for insurance products). If the profile statement was inconsistent with the prospectus or contract, the latter would prevail. Issuers could attract civil liability for any false statement made in a profile statement or for the omission of information prescribed by regulation. However, in establishing civil liability for any misleading statement made in a profile statement, the law should require that the profile statement be considered as part of the full prospectus and any due diligence defence should also apply.

A similar regime applies in New Zealand. An information statement must be given to an investor before subscription to equity issues, debt, life insurance policies, superannuation schemes or trust units. The relevant prospectus must be provided to investors on request.[24]

The CFSC should have the same range of regulatory tools at its disposal in case of misleading or fraudulent statements made in a profile statement as the ASC and ISC. That is, it should be entitled to refuse registration of a prospectus or statement on the grounds that it contains a materially misleading representation, issue a stop order on the issue of securities or policies pursuant to the prospectus, seek injunctions or take other civil action.

Recommendation 9: Profile statements should be introduced for more effective disclosure.

The law should be amended to require the issue of succinct profile statements about offers of retail financial products, including initial public offerings. These statements must contain:

- a brief description of the characteristics of the product;

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24 The New Zealand regime requires that the following questions be addressed in an information statement:

What sort of investment is this?	Who is involved in providing it?
How much do I pay?	What are the charges?
What returns will I get?	What are my risks?
Can the investment be altered?	How do I cash in my investment?
Who do I contact with queries?	Who can I complain to if there are problems?

What other information can I obtain about this investment?

- a clear and unambiguous statement of the risks involved;
- a clear and unambiguous statement of applicable fees, commissions and charges, in a form which enables comparison with similar products; and
- such other disclosures for specific products as the regulator considers appropriate.

Beyond this, the contents of a profile statement should not be prescribed by regulation, except in cases where the CFSC believes that prescription is required to provide balanced representation of the product. The format should be developed by the CFSC in consultation with industry groups.

Shorter Prospectuses

The Inquiry observed that the concern to limit liability leads many issuers to engage in costly due diligence procedures. The cost of these procedures has meant that issuing a prospectus has been priced beyond the means of many small capital raisings.

The Corporations Law Simplification Task Force has proposed a change to the Corporations Law to remove the requirement for a prospectus for businesses making a targeted offer for equity investment. The proposal is to alter the existing exemption for offers made to fewer than 20 people in 12 months. The new exemption would apply to any number of offers, provided that no more than 20 issues of securities were made in 12 months. The Inquiry endorses this proposal as a practical measure which would reduce the cost of capital raising for smaller entities without diminishing investor protection.

The Inquiry notes that a number of proposals for clarifying the liability of people named in prospectuses are being considered by the Corporations Law Simplification Task Force, including those relating to:

- the extent of liability of persons named in a prospectus but who are responsible only for part of the preparation of the prospectus; and
- a common defence for all persons who are potentially liable.

The Inquiry believes that the CFSC should play a role in educating issuers, especially those seeking to raise modest amounts of capital, about the use of shorter prospectuses and due diligence processes commensurate with the nature of the offers being made. It could play a valuable role in providing general guidance to issuers of prospectuses on its view of what the Corporations Law requires. If a matter is litigated, the final decision on whether a prospectus meets the disclosure requirements or whether a due diligence defence has been made out rests properly with the courts. However, in the vast majority of matters that do not result in litigation, issuers would benefit from guidance provided by the CFSC.

Recommendation 10: Shorter prospectuses should be encouraged.

The CFSC should work with industry and professional groups to promote more effective disclosure in prospectuses, including use of consumer testing to eliminate information overload. In particular, for smaller offerings the CFSC should encourage the use of shorter prospectuses and abridged due diligence procedures commensurate with the size of those offerings.

Financial Reporting

Part 3.6 of the Corporations Law requires Australian public corporations and large proprietary corporations to prepare financial statements and have them audited.[25] Section 298 requires the company's directors to ensure that the financial statements are made out in accordance with applicable accounting standards. These accounting standards are set by the Australian Accounting Standards Board following consultation with industry and the accounting profession.

Under Part 4.5 of the Corporations Law, Australian banks and registered life corporations are exempt from these provisions on the basis that they are already required under the *Banking Act 1959* and the *Life Insurance Act 1995*

25 Large proprietary companies are those with more than 50 employees, gross annual operating revenue of at least $10 million or consolidated gross assets of $5 million or more.

to prepare accounts in a particular form for prudential regulation purposes. These reports depart from general accounting standards, primarily because the relevant regulators have reached agreement with industry that those standards are not appropriate in some respects.

In principle, Corporations Law reporting requirements, including the requirement to comply with applicable accounting standards, should apply to all reporting entities, including banks and life companies. The Inquiry believes that specific accounting standards should be developed separately for the deposit taking and life insurance industries in conjunction with the prudential regulator.

This approach should enable financial institutions to produce one set of financial statements satisfying the requirements under both the Corporations Law and prudential legislation. To achieve this aim, it is envisaged that these accounting standards will need to take into account the specialised business of financial institutions and the impact of the prudential regulatory framework on financial claims (such as depositor priority and the existence of statutory funds).

Corporations Law reporting should also be extended to any other financial institution transferred from State / Territory to federal jurisdiction.

Recommendation 11: Financial institutions' financial reports should meet Corporations Law and prudential requirements.

As a general principle, financial institutions should be subject to the same financial reporting requirements as are other corporations under the *Corporations Law*. Action should be taken to develop, in conjunction with industry and the Australian Prudential Regulation Commission (see Recommendation 31), appropriate accounting standards for deposit taking institutions and life companies to enable them to prepare one set of financial statements meeting both *Corporations Law* and prudential legislative requirements.

In regard to financial reporting generally, the Inquiry endorses measures to harmonise Australian accounting standards with international standards.

This has the potential to reduce the cost of cross-border investment and fund raising. Some submissions recommended combining all regulatory requirements relating to financial reporting into a single Financial Reporting Act. The Inquiry considers that this proposal is worthy of further consideration by the CFSC in consultation with the APRC and industry.

Recommendation 12: Accounting standards should be harmonised with international standards.

The Australian Accounting Standards Board should, where practicable, seek to harmonise Australia's accounting standards with international standards.

7.3.3 Regulation of Financial Market Participants

Current regulatory arrangements involve complex and overlapping regulation of financial market participants:

- RBA licensing of foreign exchange dealers;
- ASC licensing of securities dealers and futures brokers;
- ASC licensing of investment advisers and futures advisers;
- ASX and SFE supervision of members;
- ISC registration of insurance brokers and foreign general insurance agents; and
- ISC regulation of life company supervision of life agents.

Particular problems arise where participants are subject to more than one regime, sometimes with contradictory rules. For example, an estimated 71 per cent of life brokers and 18 per cent of life company advisers are also licensed securities dealers.[26]

The Committee notes that the ISC and ASC have undertaken measures to harmonise their rules for life agents and investment advisers. While these

26 Based on ISC data provided to the Inquiry.

measures have gone some way to address industry concern, a dual regime adds to industry costs and creates difficulties for consumers who seek advice across a spectrum of products.

It is desirable that advisers have a broad understanding of comparable products to ensure that advice is of a high standard and takes account of the implications of substitute products for different consumers.

Convergence in investment products offered by different financial institutions and the emergence of new distribution methods require an overhaul of the existing framework. In essence, a consistent regime is required for regulating those advising on, or selling, financial products, whether they are offered by a bank, life company, unit trust or other entity.

Coverage of the Licensing Regime

To overcome anomalies and regulatory duplication, the Inquiry recommends that a regime of consistent financial market licensing be introduced under single administration by the CFSC.

In Chapter 9, the Committee concludes that separate prudential regulation of foreign exchange dealers is not appropriate. The Committee considers that the principal reason for continuing to license these dealers is to ensure consistent treatment of all financial dealers. It concludes that participants trading in foreign exchange markets should be licensed by the CFSC, and that separate licensing by the RBA should be discontinued.

The Inquiry has considered the merits of introducing a licensing regime for individual life agents. However, it considers that licensing requirements should be targeted at the entity with legal responsibility for the sales and advice process. Where an agent acts for a principal, the latter is legally responsible for the agent's actions. The Committee therefore believes that life companies rather than individual agents should be licensed. Furthermore, the degree of convergence between life company and collective investment products warrants the introduction of a single regime for retail investment advice and product sales.

Given that some clear distinctions within the financial advisory and dealing sector remain, the licensing regime should retain separate categories.

- **Investment advice and product sales** — Licences should be issued to financial institutions (where the provider of sales and advice acts on behalf of an institution) or to independent advisers (firms or individuals acting on behalf of a client). These would replace existing arrangements for investment advisers, life agents and life brokers. Financial institutions and fund managers wishing to sell retail financial products, including DTIs and life companies, would also need to obtain this licence.
- **General insurance brokers** — The CFSC should assume responsibility for registering general insurance brokers and foreign agents, a function currently undertaken by the ISC.
- **Financial markets dealers** — Licences should be issued to organisations involved in dealing on behalf of clients in financial markets or operating over-the-counter (OTC) markets. This would replace existing ASC licensing of securities dealers (including private client brokers), futures brokers and exempt market authorisations and RBA licensing of foreign exchange dealers.
- **Financial market participants** — Licences should be issued to organisations dealing in investment products as principals, except where all dealings are conducted through a licensed person. Corporates undertaking intra-group financial transactions and local members of the SFE should be permitted to operate without a licence.

Recommendation 13: A single licensing regime should be introduced for financial sales, advice and dealing.

The CFSC should establish a single regime to license advisers providing investment advice and dealing in financial markets. There should be separate categories of licence for investment advice and product sales, general insurance brokers, financial market dealers, and financial market participants.

Operation of the Licensing Regime

The licensing regime should be operated by the CFSC, with power to devolve responsibility for competency training and testing to industry bodies. As with other aspects of financial market integrity regulation, common standards and procedures should apply to licences, with supplementary requirements imposed where warranted.

Licensees should be responsible for the competency and conduct of their employees and agents. This responsibility should include joint and several liability for the activities of multi-agents as currently exists under insurance legislation. In contrast, independent investment advisers and general insurance brokers are legally responsible to their clients and should retain direct responsibility for their actions.

Recommendation 14: The CFSC should have power to delegate accreditation responsibilities to industry bodies.

The CFSC should have power to devolve responsibility for competency training and testing to industry bodies. It should also have the option to require that licence holders be members of codes of conduct or dispute schemes that meet minimum standards.

Building on previous harmonisation efforts, the development of a single licensing regime for investment advisers should ultimately result in the harmonisation of:

- minimum standards of competency and ethical behaviour;
- requirements for the disclosure of fees and adviser's capacity;
- rules on handling client property and money;
- financial resources or insurance available in cases of fraud or incompetence; and
- responsibilities for agents and employees.

Even where individual licensing is not required (eg in the case of life agents) the CFSC should work with industry bodies and financial market participants to promote higher standards of conduct and competency.

Recommendation 15: A single set of requirements should be introduced for financial sales and advice.

The CFSC should develop a single set of requirements for investment sales and advice including:

- minimum standards of competency and ethical behaviour;
- requirements for the disclosure of fees and adviser's capacity;
- rules on handling client property and money;
- financial resources or insurance available in cases of fraud or incompetence; and
- responsibilities for agents and employees.

Other Professionals Providing Financial Advice

The Inquiry considers that real estate agents promoting negatively geared investment packages are providing retail financial advice. To some extent, these activities are already regulated by State and Territory licensing of real estate agents and via the responsibility of lenders under the UCCC. The Inquiry has not reviewed the adequacy of these arrangements. It considers that a review should be undertaken with a view to requiring those real estate agents providing investment advice to obtain an investment adviser's licence, unless it can be clearly established that the existing regulatory arrangements are adequate.

Recommendation 16: Regulation of real estate agents providing financial advice should be reviewed.

The existing regulation of real estate agents should be reviewed. Real estate agents providing investment advice should be required to hold a financial advisory licence unless the review clearly establishes the adequacy of existing regulation.

Financial advice is often provided by professional advisers such as lawyers and accountants. This advice is typically provided in the context of broader advisory services offered to clients extending beyond the finance sector, often where an adviser has a wide appreciation of the business and financial circumstances of a client. In such cases, the best course is to rely upon the professional standing, ethics and self-regulatory arrangements applying to those professions.

However, a clear distinction needs to be drawn if an adviser acts on an unrebated commission or similar remuneration basis which substantially alters the character of the relationship with a client and places such advisory activities on a footing similar to that of other financial advisers. In such cases, financial market licensing should be required.

Recommendation 17: Licensing of professionals providing incidental financial advice is generally not required.

Professional advisers, such as lawyers and accountants, should not be required to hold a financial advisory licence if they provide investment advice only incidentally to their other business and rebate any commissions to clients.

Prudential Regulation of Wholesale Market Participants

In Australia, most wholesale financial market participants are prudentially regulated financial institutions. Accordingly, it is not considered necessary that the CFSC separately impose additional prudential regulation on holders of financial market licences, including dealers in securities and foreign exchange.

Regulations affecting the conduct of licensees, such as capital requirements or restrictions on investments, may be imposed for other purposes, such as to ensure that licensees are of sufficient standing (a form of 'fit and proper person' test). The CFSC may need to apply such controls through licensing obligations for the purpose of preserving market integrity or protecting investors. Self-regulatory organisations, such as financial exchanges, may also impose such requirements on their members.

However, these requirements should be kept to the minimum essential for their purpose. If a view were to emerge that more substantial prudential regulation was required in this area (eg if systemic risks in Australian securities markets developed further or prudential regulation of such markets became standard practice in overseas jurisdictions), an extension of the coverage of prudential regulation by the prudential regulator, rather than the CFSC, would be preferred.

Recommendation 18: Additional prudential regulation of financial market licence holders is not required.

It is not necessary at this time to impose additional prudential regulation, capital or risk management requirements on financial market licence holders aimed at minimising contagion or systemic risk in the event of failure. However, this situation should be kept under review by the CFSC in conjunction with the prudential and systemic stability regulators.

7.3.4 Regulation of Financial Markets and Instruments

The primary goal of regulating financial markets[27] and instruments (as distinct from those who trade in them) is to promote market efficiency and investor confidence in the integrity of financial exchanges and in OTC markets. This should ultimately enhance the capacity of financial markets to raise capital, allocate funds and manage risks.

27 Financial markets considered in this section encompass markets for debt, equities and foreign exchange. These can be further divided into primary, secondary and derivatives markets.

The ASC is the primary regulator of financial markets under the Corporations Law which imposes similar but not identical regulation on securities and futures contracts and provides for authorisation of financial exchanges and exempt financial markets.

Innovations in finance, technological developments and deregulation have heralded significant changes in products traded in financial markets and in the methods of trading those products. As a result, the regulatory regime lacks the flexibility required to deal fully with these developments and does not offer legal certainty for financial market participants in some areas. Since the pace of innovation in financial markets is unlikely to abate, there is a need to reconsider the regulatory framework.

Submissions raised a number of concerns about the existing regime:

- **incomplete coverage** — the Corporations Law does not apply to transactions falling outside strict definitions of 'securities' or a 'futures contract', including spot foreign exchange transactions and some OTC derivatives;
- **inflexibility** — the narrow definitions of 'securities' and 'futures contract' have required legislative amendments to permit exchanges to trade new products;
- **uncertainty and inconsistencies** — in the legal treatment of hybrid products with both security and derivatives characteristics (such as deliverable share futures and low exercise price options); and
- **barriers to entry** — retail consumers are effectively prohibited from transacting in OTC futures markets.

A number of submissions proposed that these concerns be addressed by a substantial redrafting of the Corporations Law.[28] This would involve replacing the current distinction between securities and futures contracts with a generic definition of a 'financial instrument' or 'financial product'. This would provide the basis for a single regime for financial markets and instruments.

28 See for example Department of the Treasury, Submission No. 143; Australian Stock Exchange, Supplementary Submission No. 135; Australian Securities Commission, Supplementary Submission No. 46, Attachment C.

In this section, the Inquiry sets out its views on aspects of the current regulation of products and financial markets.

Financial Products

The regulation of financial products should provide similar regulatory treatment for functionally equivalent products to achieve the most consistent regime possible.

To ensure the flexibility required to deal with future market developments, the regulator should have broad powers to declare whether a particular product falls within the regime. The regulator should also have powers to exempt a product where there is no demonstrated case for regulation or it is adequately regulated under a different regime.

The Inquiry supports a 'principles based' approach to financial market regulation. The law should set out generic requirements applying to all financial markets to the maximum extent possible. These should then be supplemented by specific regulations for particular classes of product. For example, prospectus disclosure and insider trading prohibitions are warranted for securities (where the issuer is presumed to have greater information about an investment than a potential purchaser) but not for derivatives (where performance is based on a financial market index or rate).

The Inquiry considers that this model has the potential to resolve the gaps in coverage (such as for spot foreign exchange trading), inconsistencies and inflexibility which are features of the current regime.

Recommendation 19: Broader regulation of 'financial products' should replace current securities and futures law.

The law covering financial markets should adopt a broad definition of 'financial products' subject to generic requirements and supplemented by specific regulation for particular classes of products. This should replace existing separate *Corporations Law* regulation of securities and futures contracts. The CFSC should have the flexibility to declare certain products to be covered by, or to be exempt from, the law.

An effect of such a generic definition would be that the Australian Stock Exchange could deal in futures products and the Sydney Futures Exchange could deal in corporate securities (see Recommendation 21).

Consumer Participation in Financial Markets

In the context of total turnover, retail consumers play a relatively minor role in financial markets. For reasons already identified, consumers require a higher degree of protection than financially sophisticated participants. However, consumer protection requirements should not impinge unduly on the operation of wholesale markets. The regulatory regime should recognise that retail consumers are rarely likely to participate directly in OTC markets and, for commercial reasons, many operators of OTC markets will choose to confine their activities to transactions with wholesale participants.

In the interests of competitive neutrality, the existing regulatory prohibition on retail consumers dealing in OTC derivatives markets should be discontinued.[29] The Inquiry recognises that similar prohibitions exist in comparable overseas markets and that many retail participants will never seek access to OTC derivatives markets. Nonetheless, the Inquiry sees no reason to prevent retail transactions outside exchanges, provided appropriate consumer protection applies.

The regulatory framework should establish clear definitions of retail consumers entitled to disclosure and other consumer protection. Such definitions may relate to:

- transaction size (eg the existing requirement for prospectus disclosure is limited to securities issues under $500,000 per investor); or
- the nature of the participant (eg along the lines of the existing test which applies to participants in OTC derivatives markets).[30]

29 The prohibition arises from the conditions which the ASC places on approvals to operate an exempt futures market under its Policy Statement 70.

30 See, for example, Companies and Securities Advisory Committee, Supplementary Submission No. 55.

As a general rule, consumer protection in the form of product disclosure, regulation of the sales and advice process and financial protections (eg fidelity funds) should apply only to transactions falling within the definition of retail transactions.

Recommendation 20: Prohibitions on retail participation in over-the-counter derivative markets should be discontinued.

The existing prohibitions on retail participation in over-the-counter (OTC) derivatives markets should be discontinued. The law should provide an additional layer of consumer protection for retail transactions compared with purely wholesale markets or transactions.

Authorisation of Exchanges

Regulation of both financial exchanges and OTC markets should be flexible and adaptive, balancing the ability of the market to respond to commercial circumstances with the need to retain public confidence in market integrity. The law should establish clear standards aimed at ensuring markets are fair and efficient without setting out detailed prescriptions about how those standards should be achieved.

In forming the regulatory framework, the Inquiry is conscious that market developments tend to blur the distinctions between financial exchanges (securities and futures) and OTC markets. For example, the ASX provides a market in options and other financial derivatives and the SFE has sought approval to conduct OTC markets. Technological developments make it possible for an individual financial market participant to offer centralised trading platforms competing directly with exchanges. Derivatives markets now offer a range of clearing mechanisms with varying degrees of counterparty risk. New approaches such as bilaterally negotiated derivatives transactions cleared through a centralised system are now technically feasible.

Adopting a ‘principles based’ approach to regulating financial markets including a single authorisation procedure for financial exchanges (regardless of whether an exchange trades securities, derivatives or both) should facilitate competition between authorised exchanges. The Inquiry acknowledges concerns that establishment of new exchanges could lead to market fragmentation and duplication of overhead costs. In addition, the operation of two exchanges trading the same securities raises complex policy issues. However, the Inquiry does not believe these concerns should preclude the entry of new exchanges.[31]

Under this ‘principles based’ approach, the Inquiry envisages that different rules may apply to different markets, depending on factors such as their proposed size, the nature of products, participants and technologies adopted. Clearly the means of achieving these objectives will be more complex for a full-service exchange than for a small exchange trading a limited product range.

Formal exchanges should continue to be subject to more detailed regulatory requirements than OTC markets, in part because they operate a centralised market open to a large number of participants.

The blurring of the distinctions between exchanges and OTC markets means that it is difficult to specify which markets should be required to seek formal authorisation as financial exchanges.

The regulatory framework for financial exchanges should provide for initial approval and ongoing oversight by the CFSC. The CFSC’s focus should be to ensure that the exchange operates a fair and efficient market. This encompasses trading, clearing, settlement and financial strength (ie fidelity fund) arrangements. Power to impose conditions on markets and disallow amendments to exchange business and listing rules should be vested in the CFSC — rather than the Treasurer as is currently the case (see Recommendation 5). To assist coordination, the law should also set out the basis for information sharing between the CFSC and the exchanges.

31 These issues are considered in ASC 1995.

Recommendation 21: The CFSC should authorise financial exchanges under a single regime.

The CFSC should be empowered to grant authorisation to operate a financial market to any corporation meeting objective criteria aimed at ensuring that it will operate a fair and efficient market. There should be a single authorisation procedure for financial exchanges. The conditions attaching to authorisation will depend on the nature of the market authorised.

Requirements for Exchange Trading

The Committee considers that whether a transaction is conducted on exchange or in an OTC market should generally be left to market forces, rather than determined in legislation. It will, however, remain open to individual financial exchanges to impose restrictions on off-exchange trading by members. The Committee envisages that existing restrictions on off-exchange futures trading will continue.

Given that exchanges and OTC markets can be in direct competition, the CFSC's charter should include a responsibility to ensure that the regulation of exchanges is not excessive compared with OTC markets. The CFSC should focus on post-vetting against clearly articulated market integrity objectives, rather than approving individual exchange products or acting as the front line regulator of exchange members.

Recommendation 22: Regulation of exchanges should not be excessive compared with OTC markets.

The CFSC's charter should include a responsibility to ensure that the regulation of exchanges is not excessive compared with OTC markets. Market forces, rather than legislation, should determine whether a transaction is conducted on exchange or in an OTC market.

OTC markets should be regulated to reduce the likelihood of operational failure by ensuring that they are conducted by organisations with adequate financial standing and risk management procedures. The CFSC may regard the fact that financial institutions are prudentially regulated as evidence that operational risks are contained.

To assist the RBA in its containment of systemic risk, the CFSC should be empowered to collect statistical information in all OTC markets and to share this information with the RBA.

Under current arrangements, the operator of an exempt market must obtain a securities dealer's licence as well as Ministerial approval to conduct an exempt securities or futures market. The Inquiry considers that the same regulatory objectives can be achieved through the licensing regime. That is, a holder of a financial market dealer's licence would be permitted to operate an OTC financial market, subject to any additional conditions necessary to ensure that the market was fair and operational risks were contained. There is no apparent need to impose a separate requirement for exempt market approvals.

Recommendation 23: OTC markets may be conducted by appropriately licensed intermediaries.

The CFSC should have power to authorise a financial market dealer to operate an OTC market, subject to any conditions necessary to ensure that the market is conducted fairly and that operational risks are contained. There should be no separate authorisation of exempt markets.

Exchange Clearing Houses

Each financial exchange should be required to demonstrate that it has fair and efficient clearing and settlement arrangements, including appropriate risk management, resource backing and systems. This assessment process will need to take account of the particular clearing arrangements adopted — for example, the greater risks borne by derivatives clearing houses involved in novation clearing may warrant closer scrutiny.

The Inquiry has considered whether it is appropriate to alter the current arrangements for the authorisation of clearing houses by the Minister. Consistent with Recommendations 5 and 21, the power to authorise clearing houses should be vested in the CFSC rather than the Minister. Apart from that change, the Inquiry believes it is appropriate to retain the current arrangements:

- clearing houses take on major financial risks in the event of counterparty failure, and are essential to the proper functioning of financial markets;
- systemic risks do not currently pose a sufficient threat to warrant transferring responsibility for their regulation to the prudential regulator; and
- Australia's international standing could be adversely affected by reducing the current regulation of clearing houses.

Recommendation 24: Exchange clearing houses should be appropriately authorised.

The CFSC should consider the appropriateness of proposed clearing and settlement arrangements as part of its oversight of financial exchanges and should be responsible for authorising financial exchange clearing houses.

7.3.5 Corporations Law

Concerns have been raised about the complexity of the Corporations Law in Australia compared with comparable jurisdictions and the possible implications for domestic corporations seeking to raise funds in Australia.

It was suggested that the degree of complexity and prescription in the Corporations Law makes it difficult to respond to new products, activities or structures promptly. The ASX argued that the Corporations Law should be fundamentally rewritten into a high-level policy document covering the core subjects of basic framework, takeovers, markets and intermediaries, and fundraising.[32] This would be supplemented by greater reliance on subordinate legislation (such as regulations, practice notes and exchange rules) and the discretionary powers of the regulator.

In March 1997, the Treasurer announced a reform program intended to improve the content and implementation of the Corporations Law.[33]

The Inquiry's Terms of Reference cover the matters dealt with in Chapter 7 (Securities) and Chapter 8 (Futures) of the Corporations Law, but do not extend to the general regulation of corporations.

The Inquiry sees merit in simplifying the Corporations Law to the greatest extent possible while maintaining its effectiveness.

7.3.6 Complaints Handling and Dispute Resolution

There are two key issues in complaints handling and dispute resolution:

- whether the existing dispute resolution arrangements should be rationalised; and
- whether the coverage of the codes of conduct should be broadened, particularly to include small business.

Dispute Resolution Arrangements

Several dispute resolution schemes operate in the financial system. They have been established by particular industries, or sectors of industries, to resolve (usually cost free) disputes between industry members and their customers. The Superannuation Complaints Tribunal (SCT), unlike other dispute resolution schemes, was established by legislation and is controlled by government and not by industry.

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32 Australian Stock Exchange, Supplementary Submission No. 135, p. 4.
33 Costello 1997.

Rationalisation of Arrangements

The existence and effectiveness of a scheme depend heavily on the industry association which establishes it. As a consequence, each scheme has developed a different approach to suit its members, resources, products and customers.

The financial system is not comprehensively covered by dispute resolution schemes. Rather, there exist various gaps, overlaps and inconsistencies in the provision of schemes, including:

- the absence of a scheme to deal with complaints about some sectors of the financial system, such as finance companies and mortgage originators;
- overlapping complaints schemes for investment products, namely the SCT and industry schemes conducted by financial planning and life insurance industries; and
- inconsistency in coverage by the various schemes of small business and in the monetary limits of each scheme.[34]

To some extent, inconsistency among schemes may be justified by the differing nature of the products in particular industry sectors. The focus to date has been on establishing and operating the schemes, rather than on achieving consistency among schemes. However, concerns have been expressed that the complexity of financial services and their convergence with other services will result in consumers feeling bewildered in the face of the diversity of schemes.

A number of informal cooperative arrangements have been introduced to improve consistency and achieve more seamless service delivery.

- In view of the convergence between financial services and communications, the Australian Banking Industry Ombudsman (ABIO), Life Insurance Complaints Service and Insurance Enquiries and Complaints Scheme have joined with the Telecommunications Industry Ombudsman to establish a cooperative approach on common issues.

34 Department of Industry, Science and Tourism, Submission No. 243, p. 13.

- The Federal Bureau of Consumer Affairs has produced a directory of dispute resolution schemes and complaints handling organisations to assist consumers and small businesses to find an appropriate avenue for redress.
- To encourage and support the development of customer dispute resolution schemes, the Commonwealth Government (through the Federal Bureau of Consumer Affairs) has developed a set of benchmarks to guide industry in developing and improving such schemes. Voluntary adherence to the benchmarks will provide some measure of consistency across dispute resolution schemes in the financial system.

However, it is timely to consider whether further action needs to be taken. In particular, could the cost effectiveness of the schemes be increased through greater efforts at coordination or rationalisation?

The Inquiry recognises the value of effective industry self-regulation in reducing the need for government intervention. Dispute resolution schemes enable industry to ascertain the problems faced by their customers and to take steps to rectify them. Their development and success to date have relied heavily on industry ownership. Hence the Inquiry does not support suggestions that the schemes be amalgamated. However, the Inquiry does see merit in the proposal that a central referral service be established for all consumers of retail financial products and services. That referral service should be funded by retail financial service providers on a cost recovery basis.

Recommendation 25: A central gateway for dispute resolution should be established.

The CFSC should facilitate the creation of a central complaints referral service for all consumers of retail financial products and services, funded by retail financial service providers on a cost recovery basis.

Broadening Coverage of Arrangements

Judging from submissions made to the Inquiry, a number of consumer problems and disputes are not adequately covered by existing dispute resolution schemes. One of the objectives of the CFSC will be to identify gaps in coverage and how they might be addressed. Two areas which raise concerns are the absence of a scheme for finance companies and the exclusion from most of the existing schemes of small business complaints.[35]

There is no scheme hearing complaints about finance companies, although finance companies are involved in many disputes under the credit laws. The establishment of a dispute resolution scheme covering finance companies could reduce pressure on the courts and the legal aid system.

Only the General Insurance Enquiries and Complaints Scheme and the National Insurance Brokers' Association of Australia specifically hear complaints by small business. Incorporated small businesses are not heard by the other schemes. Operators of small businesses generally have a higher degree of commercial expertise than consumers, and the risks attached to lending to small businesses are quite different to other forms of lending. However, a system of dispute mediation in which each party bears its share of the costs would be appropriate for this sector.

The ABIO scheme, covering the banking industry, does not extend to small incorporated businesses. An indication of the pressure to extend the scheme to cover incorporated small business and finance companies is provided in Table 7.2, which shows the percentage of complaints received by the ABIO which are outside its terms of reference because they involve either small business or non-bank financial institutions.

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35 Other gaps include friendly societies, licensed advisers who are not members of the Financial Planning Association, non-licensed advisers, mortgage originators and excluded superannuation funds.

A Large Proportion of Complaints to the Ombudsman are outside the Terms of Reference . . .

Table 7.2: Complaints Outside the Terms of Reference of the Australian Banking Industry Ombudsman Scheme (percentage of total complaints)

Reason outside terms of reference	1993-94	1994-95	1995-96
Complaints by corporations	29.3	27.0	25.5
Complaints against non-bank financial institutions	28.2	42.4	38.4

Source: Australian Banking Industry Ombudsman, Submission No. 55, p. 7.

Recommendation 26: Coverage of dispute resolution schemes should be broader.

The States and Territories should facilitate the creation of a nationally uniform dispute resolution scheme for finance companies.

All dispute resolution schemes should be encouraged to extend their coverage to small business on the basis that the cost of operation should be shared by each party to a dispute.

7.3.7 Regulatory Effectiveness

Regulations need to be flexible in the face of rapid developments in the financial system and be capable of being enforced and administered in the most cost-effective way. While much enforcement will inevitably require government action, some aspects of administering regulation may be more quickly and efficiently performed by self-regulatory bodies.

Enforcement Powers

Many areas of the law are self-enforcing, as those seriously affected by particular conduct can be relied upon to seek redress. But many consumers of retail financial services have a generally low level of financial sophistication and the level of individual damage caused is often small relative to the high cost of legal redress. Further, to preserve the integrity of financial markets, it is often necessary to take speedy administrative action to correct a manipulation of the market or an information imbalance. This type of speedy administrative action is not generally available to private litigants.

It is therefore important that the CFSC have available a full range of enforcement options.

Recommendation 27: The CFSC should have broad enforcement powers.

The CFSC should be provided with adequate enforcement powers including:

- appropriate regulatory and investigative powers, including powers to obtain documents and question persons involved in the relevant conduct and to accept legally enforceable undertakings;
- provision for protection from liability for those who provide investigative assistance;
- power to impose administrative sanctions, such as banning or disqualification orders;
- power to initiate civil actions, to seek:
  - punitive court orders such as financial penalties;
  - a range of remedial court orders, including restitution orders, injunctions and corrective advertising orders; and
- power to initiate, and to refer matters to the Director of Public Prosecutions for, criminal prosecution.

The CFSC should be provided with adequate resources to meet its mission and to allow for effective regional representation so that it is readily accessible and well placed to perform its registration, inspection and investigation functions.

Regulation of New Technologies in a Global Context

Developments in telecommunications and computing technologies are likely to deliver significant changes to the ways in which financial services are delivered. There are implications for the financial system and the role of the CFSC of an increased use of new technologies and in the scale of cross-border sales of financial services.

New Technologies

Increasingly, it is possible for financial institutions to service customers at their homes or offices (through telephones and on-line computer networks) or at automated teller machines, bank booths and retail outlets (through the use of electronic cards).

The impact of these changes will depend very much on the acceptance and take up of new electronic service delivery mechanisms by consumers. Evidence emerging indicates that consumer take up may be slower and less decisive than technology enthusiasts are predicting. The rate of take up of new delivery channels will be influenced by the extent to which consumers feel confident about operating through these means. The adoption of new forms of service delivery by financial institutions raises a range of consumer protection issues. The main issues are:

- liability for loss, errors and unauthorised transactions;
- responsibility for financial advice provided through electronic means such as intelligent agents;
- security of transactions and payment details;
- privacy concerns associated with collection, storage and use of data;
- provision and legal status of transactions records and audit trails;
- appropriateness of pricing and allocation of costs;
- availability of dispute resolution procedures; and

- suitability of precontractual disclosure requirements relating to products and services.

As far as possible, there should be consistency of regulation between products and between service delivery channels that serve the same function and have similar characteristics. Currently, this is not the case. The Electronic Funds Transfer Code of Conduct has developed special rules to govern transactions made with a personal identification number and a card. However, there is to date no code or other regulatory mechanism applying to transactions made with a smart card or to home banking transactions, with the result that differing terms and conditions apply to the services offered by different institutions.[36]

According to the ACCC, experience has shown that institutions have, on the whole, been reactive rather than proactive in responding to such consumer concerns.[37] There is a role for the CFSC to ensure that these issues are addressed in a coordinated way.

Recommendation 28: The CFSC should monitor new technologies.

The CFSC should ensure that industry initiatives for consumer protection in relation to new technologies develop in a coordinated way. It should also monitor the development of codes of conduct in relation to retail electronic banking and facilitate consistency across media as far as possible.

Globalisation

International sales of financial services are not a new phenomenon. However, they have been restrained at the retail level by transaction costs.

36 Australian Competition and Consumer Commission, Supplementary Submission No. 79, p. 41.

37 Relevant examples cited were EFT Code, substantially developed by government, and telephone banking where agreed standards have not been introduced by many institutions. Australian Competition and Consumer Commission, Supplementary Submission No. 79, pp. 41-42.

New technologies may reduce some of these costs, making it easier to provide financial services in countries where the service provider does not have a physical presence.

Because wholesale markets are substantially global, and retail markets are becoming increasingly so, the regulatory agency needs to be aware of the importance of harmonisation with international standards. The internationalisation of financial markets places greater pressure on the regulator to ensure that the regulatory structure is internationally competitive. Otherwise customers will shop outside of the national market through the Internet and other technology driven media. A harmonised, progressive and world class regulatory structure will provide Australia with a significant competitive advantage both regionally within the Asia Pacific region and globally.

In performing its role, the CFSC will need to ensure as far as possible that firms subject to domestic regulation are not placed at a competitive disadvantage relative to overseas firms in comparable jurisdictions.

Subject to the overriding imperatives of systemic stability, market integrity and consumer protection, regulation should not impede the development of debt and equity markets because:

- competition between markets should be promoted; and
- existing markets have gaps which could usefully be filled by new markets.

Generally speaking, consumers are not protected in their direct dealings with overseas financial service providers. A financial service offered from abroad on the Internet may be fraudulent or the offerer may engage in misleading and deceptive conduct. Misleading information could be provided about the issues or about the financial product. If complaints or disputes arise, it may be significantly more difficult for a customer to obtain satisfaction or redress from overseas suppliers. There may also be problems with the security of transactions. Similar issues arise in relation to the supply of retail financial services to overseas customers by Australian based providers.

In practice, consumers accessing financial services through such media as the Internet squarely face the 'buyer beware' doctrine.[38] To a considerable degree, the market itself must supply solutions which will enable consumers to use services with confidence. Solutions might include suppliers offering means for assuring the rights of their customers or the development of independent accreditation services. Security is also vital and encryption and other mechanisms are being pursued to meet this need.

The Inquiry notes that Australian regulators have begun to pursue greater international cooperation and information sharing and have established new formal and informal alliances. There are attempts to establish international norms. For example, the International Organisation of Securities Commissions has a working group whose mandate includes disclosure issues to facilitate cross-border listings and issuance.

International cooperation among regulators is both necessary and worthwhile. It is important that the Australian regulators be open to, and participate in, international cooperation.

Recommendation 29: The CFSC should participate in global regulatory programs.

The CFSC should work with overseas regulatory and industry bodies to provide consumer protection for cross-border financial transactions and to avoid the potential for fraud. To this end, the CFSC should be empowered to:

- enter into bilateral and multilateral mutual assistance treaties with overseas counterparts;
- encourage the creation of international codes of conduct;
- develop mutual industry recognition or harmonisation regimes; and
- develop, with industry, education programs for consumers on cross-border dealings.

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38 An exception to this principle could include a regulator providing through its home page access to corporations' prospectuses and other disclosure documents as a signal that these corporations are subject to its jurisdiction.