

## **SUBMISSION TO THE PARLIAMENTARY JOINT COMMITTEE INQUIRY INTO FINANCIAL PRODUCTS AND SERVICES**

This submission seeks to address the following terms of reference of the Australian Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Financial Products and Services and also makes some recommendations:

### **Terms of Reference Considered:**

- The general regulatory environment for these products and services
- The appropriateness of information and advice provided to consumers considering investing in those products and services, and how the interests of consumers can best be served
- Consumer education and understanding of these financial products and services
- The need for any legislative or regulatory change

**General Recommendations:** Provide a better definition of financial products and services and also relate it to the Australian and New Zealand Standard Industrial Classification (ANZSIC) system, as discussed below. Undertake related policy direction outlined in the G20 London Summit Leaders Statement and related Declaration on Strengthening the Financial Systems (2.4.09). Consider implementation of related policy directions in attachments. These aim to open markets and gain the benefits of a low carbon future by assisting more scientific comparative considerations of profit and non-profit scheme designs to achieve economic, social and environmental goals. This extends the embryonic ‘Compare the pair’ cost cutting approach in industry superannuation.

The current submission primarily addresses the above inquiry terms by considering the current definitions of financial products and services. The aim is to re-design them so they can reflect industrial reality better in many related ANZSIC classifications. The submission and attachments provide evidence that current definitions of financial products, services and related law are driven more by the interests of providers rather than consumers and that financial trades are far from bargains struck on a level playing field. A clearer, more concise, more comprehensive, more cost-effective and less biased definition of a financial product or service than the one apparently outlined in the Corporations Act 2001 is therefore offered, to reflect the industry key functions. It is:

**A financial product or service is a facility or activity which aims to assist trade through assisting:**

- **savings and or/deposit custody**
- **borrowing and/or lending**
- **investment and/or returns on investment**
- **insurance, re-insurance or related hedging**

The concept of risk is normally related to uncertainty. In business a risk is ideally reduced by the provision of more information and/or other investment protections,

including insurance, and by creating more stable investment environments. The latter course is recommended. See related attached discussion on executive remuneration.

## **TOWARDS CLEARER ACCOUNTING FOR ALL PRODUCTS AND SERVICES**

For every consumer there is a producer and supplier of the product or service consumed. The producer and supplier of the product or service may be the same or different groups or individuals. However, all are part of the broader conceptual class of traders, which also includes borrowers, lenders and investors. All traders are part of a great variety of broader communities which are defined internationally by their geographic location and many other varieties of mutual interests and associations, as has been recognised by the United Nations (UN) and its instrumentalities in related conventions which many nations, including Australia, support. All laws ideally conceptualize all those engaged in trade consistently unless another course of action appears better for good reasons. The ANZSIC and related occupation classifications have been designed to assist this. Such classification systems ideally guide trade and industry related data gathering in a manner which embraces their systemic questioning and reformulation from scientific perspectives. The administration of prescriptive law, on the other hand, is pre-scientific. Laws require aims.

Finance and insurance services support all industries. The intention of the new, suggested definition of a financial product or service outlined earlier is to identify the roles of all product and service consumers and providers in the ANZSIC Finance and insurance industry class as clearly and comprehensively as possible, to increase transparency and to improve all products and services in future, through more effectively designed research in any industry. A related aim is to reduce the costs to financial consumers which are driven by legal and financial providers whose goal has been to grow rich partly by increasing the confusion and costs arising from the increasingly opaque and irrational financial systems they apply to advance their interests.

The world appears to have been traveling towards perfect financial ignorance rather than perfect financial information via the commercial in confidence transactions of financial markets and is now facing a financial crisis of unknown breadth and depth. Six of the twelve richest men in Australia in 2006/2007 were bankers, according to an article entitled 'The case for a new top tax rate' by Richard Denniss on the Australia Institute website. Macquarie's Allan Moss made \$1,645,000, in comparison with the Prime Minister's salary of \$330,000. To a historian, the idea that a man's income reflects the real value to society of the work he does often seems stupid yet it is a happy assumption on which much economic theory appears to rest. Income may often be more reasonably viewed as the reflection of legal and financial controlling power. In both the global and national contexts it is vital to implement the London Summit Leaders Statement and Declaration on Strengthening the Financial System made on 2.4.09, because the currently driving legal and financial behaviour rests on the accretion of self interested feudal assumptions and behaviour rather than more broadly scientific approaches. The antidote is clarity and open comparison, which finance lawyers hinder.

The government Standing Committee on Economics, Finance and Public Administration (2006) supported the use of ANZSIC and so does the Productivity Commission (PC). Do academics? ANZSIC service industries are:

- Electricity gas and water
- Construction
- Wholesale trade
- Retail trade
- Accommodation, cafes and restaurants
- Transport and storage
- Communication services
- Finance and insurance
- Property and business services
- Government administration and defence
- Education
- Health and community services
- Cultural and recreational services
- Personal and other services

The current inquiry into financial products and services ideally refers to the Finance and insurance ANZSIC category of services, which also underpins all other primary, manufacturing or service production. The inquiry terms of reference state that Section 763A and 766A of the Corporations Act 2001 respectively set out the general definition of a financial product and a financial service. These definitions are addressed below with comment on some key problems. A better way forward is recommended.

## **THE NEED FOR CLEARER DEFINITIONS AND SCIENTIFIC APPROACHES**

In 'The Language of Money', Carew states that the term 'product' once used to mean something tangible, which resulted from creative effort and usually involved physical energy and machinery. However, she claims that in the language of finance, 'the word 'product' now means something that can be sold, bartered, taken advantage of or just talked about' (1996, p.263). Her book does not define a service, but I guess that financial services are called products to give what may be highly speculative and intangible forms of value a spurious air of dependable solidity for mum and dad investors – just like me. In highly competitive financial markets, with lots of financial market players, we may be encouraged by those competing to sell financial products, to enter into many mysterious transactions on the expert premise that these will be good for us, although they often turn out later to be beyond our means and we default. In more uncompetitive markets, with fewer players, like Australia, the traditional worry appears to be that the cost of finance for consumers is too high. The Australian Competition and Consumer Commission (ACCC) flits around like Goldilocks, presumably helping governments to decide when the number of service providers is just right. Senior financiers in the most competitive markets, such as the US, appear to have made most money, which may surprise traditional economists.

An attached submission accordingly responds to the Treasury paper entitled 'An Australian consumer law: Fair markets – confident consumers' (09) and argues laws should have clear objects and definitions of key terms which are as close as is reasonably

expected to those in a dictionary. It also argues the Trade Practices Act (TPA) should be repealed along with associated outdated legislation. Hilmer (1993) defined competition as ‘striving or potential striving of two or more persons or organizations against one another for the same or related objects’. This should have led to triple bottom line accounting – economic, social and environmental. However, his view was wrongly implemented and the TPA only recognizes competition for money. National competition policy ideally requires private and public sector service providers to compete on a national level playing field of standards which ideally apply equally to all competing operations. Separation of national policy from supporting service management ideally allows the outcomes of all competing service managers to be judged in regard to how comparatively effectively their management achieves the mission or standards which have been agreed more broadly. The competition policy principles Hilmer and Australian governments envisaged should guide a new Competition Act under which the more sensible elements of the TPA and related outdated legislation are then incorporated in the form of updated regulations, codes of practice or guidance notes as appropriate. This was the approach taken to the plethora of outdated, prescriptive and inconsistent safety legislation when new state occupational health and safety acts were introduced throughout Australia in the 1980s.

Service is defined by the common dictionary as ‘work carried out under or for another’. It defines a ‘product’ as the result of a process of manufacture. The Australian Services Roundtable defined ‘services’ as follows:

Services deliver help, utility or care, an experience, information or other intellectual content. The majority of the value of that activity is intangible rather than residing in any physical product (The Committee on Economics, Finance and Public Administration inquiry into the current and future directions of Australia’s service industries, 2006, p.5).

It is usually an unhelpful and costly legal practice to define a word by repeating the word which is ideally defined. However, the above statement is valuable because it recognizes the accumulated knowledge which often resides in the persons who may provide services (and/or produce products). It should be noted, however, that much lawyers’ ‘knowledge’ is in regard to feudal rules and related mumbo jumbo which may be rubbish from any later, scientific perspective. Current scientific approaches may be conveniently dated from the European Enlightenment, when the utility of dictionaries for classifications and related scientific purposes was recognized. Legal ‘interpretations’, however, still rule us all.

Section 763A of the Corporation Act 2001 apparently sets out the general definition of a financial product as follows:

- (1)...a financial product is a facility through which, or through the acquisition of which, a person does one or more of the following:*
- (a) makes a financial investment.....*
  - (b) manages financial risk.....*
  - (c) makes non-cash payments.....*

*(2).....a particular facility that is of a kind through which people commonly make financial investments, manage financial risks or make non-cash payments is a financial product even if that facility is acquired by a particular person for some other purpose.*

*(3)A facility does not cease to be a financial product merely because:*

*(a) the facility has been acquired by a person other than the person to whom it was originally issued; and*

*(b) that person, in acquiring the product, was not making a financial investment or managing a financial risk*

In regard to (1) above, the concept of personal ‘ownership’ is one of the central principles of capitalism and its supporters have often been prepared to kill or die for it. Yet one can only guess that the above distinction in regard to a facility - ‘*through which or through the acquisition of which*’ - is designed to support short-selling in a virtual trading world where owning a product is not necessary for trading it. Is this so? A related concern with (1) above is that the term ‘person’ rather than the use of more specific terms such as financial product or service ‘consumer’ or ‘provider’ may make many roles less clear than is desirable for proper accountability. For example, although I believe I own my retirement funds and that UniSuper manages them on my behalf, I get the impression that UniSuper thinks they own my money and that I manage it. Apparent financial confusion is often encountered which appears unnecessary but which is driven by bad legislation.

The reason for the caveats in (2) and (3) above are not clear. Do they mean that even if a person acquires a loan of money for a purpose which is not primarily to make more money, the loan will still be treated as a financial product for all related purposes? If so, this appears to raise unnecessary and undesirable costs for the non-profit sector and for people who wish to buy a house in order to live and raise a family in it, rather than to sell it soon to make more money. The statement in (2) and (3), if my interpretation is correct, appears likely to encourage turnover to inflate housing prices, to the detriment of renters and the younger generations who seek to purchase homes to live in, rather than to trade or let and thereby make a profit.

Some associated problems are discussed with related recommendations in the attached article entitled ‘An Ideal Trust Structure for the Beneficiaries: An Example from an Australian Superannuation Fund and a Bank’. The attached submission to the current Victorian Competition and Efficiency Commission Inquiry into a Sustainable Future for Australia also discusses the related prescribed private or public funds non-profit management model, which is described in the Australian Treasury Paper entitled Improving the Integrity of Prescribed Private Funds. This is further addressed in other attachments. Specific Treasury financial structures are suggested for consideration by industry superannuation fund managers, governments and others, as a way of supporting projects aimed at improving social welfare and achieving a low carbon future in which biodiversity can be valued more appropriately.

Section 766A of the Corporation Act 2001 apparently indicates that:

*(1).....a person provides a financial service if they:*

- (a) provide financial product advice.....;or*
- (b) deal in a financial product.....;or*
- (c) make a market for a financial product.....;or*
- (d) operate a registered scheme; or.....*
- (e) Provide a custodial or despository service.....;or*
- (f) Engage in conduct of a kind prescribed by regulations made for the purposes of this paragraph*

The concept of a registered scheme seems too unclear to be useful because one may have a registered scheme in any industry for anything. There appears to be little attempt in the current definition to provide conceptual clarity. In general, one may hear the lawyers gearing up to argue over whether a financial undertaking is a product or a service.

## **CONCLUSION**

As a result of this analysis the following definition is again recommended:

**A financial product or service is a facility or activity which aims to assist trade through assisting:**

- **savings and or/deposit custody**
- **borrowing and/or lending**
- **investment and/or returns on investment**
- **insurance, re-insurance or related hedging**

See the related submission on key questions from the Productivity Commission (PC 2009) paper entitled ‘Regulation of Director and Executive Remuneration in Australia’ attached. It argues that the PC ideally needs to put clear discussion of the terms ‘director’ and ‘the executive’ before discussion of remuneration, because remuneration is ideally designed to serve clearly specified roles and functions to achieve the organizational goals. The importance of advertising and selection procedures also must be recognized, because the wider the selection pools, the more potential there is to make high quality, comparatively cheap appointments. The main advice is that investors should enter well designed Treasury investment schemes which openly compete against others, because trying to regulate normally accepted commercial in confidence behaviour using lawyers is likely to be a big waste of time and money. This is also relevant to your inquiry.

Thank you for the opportunity to make this submission.  
Yours truly, Carol O’Donnell, St James Court

## **REVIEW OF GENERAL INSURANCE CODE OF PRACTICE AND NSW BAR**

As a lover of codes, I write primarily to send congratulations on the clarity of the 'General Insurance Code of Practice'. The only quibble is that you introduce 'FOS', to the text but only explain later, in a tiny footnote, that it stands for Financial Ombudsman Service. Nevertheless, one yearns for more of such clarity in future as you may see from the submissions on construction and related financial matters below and attached.

I now turn to the future of marine and related insurance and to the Leader of the Opposition (LOO). According to Annabel Crabbe's article entitled 'Stop at Nothing: The Life and Adventures of Malcolm Turnbull' in the most recent issue of Quarterly Essays, the LOO's advice to the press gallery was 'Don't be dull' (p. 3). Crabbe later states that in many ways Malcolm Turnbull is the kind of prime minister you'd want Australia to have: clever, outrageous, fearless and interesting. By instinct, he is a discloser (p. 15). Tim Costello has apparently described him as a force of nature, and I do too.

Who cares about being Prime Minister, if one can have one's magic pudding and eat it too? The LOO should use his declared shareholdings in four listed companies, five unlisted public companies, eight private companies and twenty-five management funds for public education and sustainable industry development purposes. (I say nothing of the boats, artworks, books and furniture (p. 71). What is the point of life if the key policies politicians publicly espouse are being undermined by their personal and related investment actions? As a superannuation investor I would also like to know that my money will be spent in safer and green investments. The latter appear very risky and one also wonders if the 'socially responsible' tag is merely another lie to keep us happy.

Transport insurance and audit practice are obviously key concerns in a global economy. For the sake of history and the future, I would first like to know more about the Costigan Royal Commission, which was convened to investigate the Federated Ship Painters and Dockers Union and which involved allegations against a powerful figure some thought was Kerry Packer. The NSW people have a right to know more about what Malcolm Turnbull knew as Packer's lawyer. We do not want Australian ports and transport to be increasingly in the global chain Roberto Saviano described in 'Gomorra: Italy's other Mafia'. The casual tourist may often feel the problem of corruption on Italian railways.

Annabel Crabbe states that Lucy Turnbull is not just a supportive spouse, but a lawyer, businesswoman and politician in her own right (34), and she and Malcolm appear to hold each other in very high regard. As a comparatively free and independent modern woman, she should be spoken with at length. As she has always lived intimately with it, rather than merely wondering what it is doing from afar, one wonders how she feels about the NSW Bar. Such issues should be discussed by women. (Who cares what Ellis thinks?)

Your truly  
Carol O'Donnell, St James Court.