

FOCUS

FINANCIAL SERVICES



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CORPORATE AND FINANCIAL SERVICES REGULATION REFORM

The 16 November 2006 release of the *Corporate and Financial Services Regulation Review Proposals Paper* is the Federal Government's latest strategy to improve and simplify the regulatory system in Australia's corporate and financial services sectors. Senior Associate Justine Woodford summarises the Government's latest proposals.

A new Victorian Government policy – Standard Commercial Principles – will be a big step forward in terms of the PPP process in that state

HOW DOES IT AFFECT YOU?

- The paper addresses concerns previously raised about unnecessary consequences arising from financial services reform and other *Corporations Act 2001* (Cth) requirements.
- The proposals are broadly consistent with what was included in the earlier consultation paper, although there are some new proposals and concepts. For example, representatives can be either advisers or sales representatives – not both; registered managed investment schemes will be able to invest in unregistered foreign managed investment schemes and electronic distribution of annual reports will be permitted.
- Superannuation is excluded from the statement of advice relief provisions.
- Some forms of fundraising will be easier. For example, rights issues for quoted securities or quoted financial products will not require a prospectus or product disclosure statement; more 'small-scale' offerings will be able to be made under an offer information statement; unlisted company employee share schemes will generally be exempt from licensing, advertising and hawking restrictions and subject to simpler disclosure requirements.
- Some proposals effectively create more regulation, for example, the Financial Product Activity Report, which will be a significant compliance burden.
- In practical terms, regulation could be more complex because it will be necessary to know, and understand the scope of, the new exceptions.



BACKGROUND

In April 2006, we reported on the release by the Federal Government of the Corporate and Financial Services Regulation Review Consultation Paper (*the consultation paper*). See *AAR Focus: Corporate and financial services reform* – April 2006. As a result of feedback received on the consultation paper, the Government issued in August 2006 a list categorising how it proposed to progress the consultation paper topics (*the proposed categories list*). The proposed categories list is outlined in *AAR Focus: Financial Services* – August 2006.

THE PROPOSALS PAPER

The *Corporate and Financial Services Regulation Review Proposals Paper* (*the proposals paper*) contains details of the issues which, once finalised, the Government will implement through legislation. It contains 35 issues that fall into two broad categories: financial services regulation (**FSR**) and corporate.

For the most part, the issues in the proposals paper are broadly consistent with the objectives identified in the consultation paper and it has been generally well received by industry. However:

- new issues have been included which, in some cases, develop recommendations made by the Banks Taskforce in its report *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*¹;
- the focus of some issues has changed from the consultation paper; and
- the Government has identified some issues that are no longer being pursued.

For a more detailed description and discussion of all of the issues, refer to our tables which identify each issue, the proposed change(s), the objectives that the Government is trying to achieve and, where applicable, provide some additional commentary.

Below is a summary of the main issues in the proposals paper.

The key proposed FSR-related changes are as follows.

- Financial product providers and their representatives would be able to recommend financial products (except for superannuation-related products) based on a client's objectives, financial situation and needs without that recommendation constituting financial advice (either personal or general). This would be defined as a 'financial product sales recommendation' and would be subject to its own specific regulatory requirements. This would be distinguished from the provision of financial services advice. They would be mutually exclusive streams of activity so that an individual representative could do one but not both. This is a new approach to defining financial services advice under FSR.
- Financial advisers providing general advice would not have to provide a statement of advice (SOA) when the advice does not involve recommending a product and no remuneration is received for it. The adviser would, however, need to keep a record of advice (to be provided to the client if requested).
- There would be a threshold limit triggering the requirement to provide an SOA to a client. SOAs would no longer be required where the advice given relates to an investment worth less than \$10,000 (although it is not proposed that the exemption apply to superannuation-related products², some insurance products (life risk, sickness and accident and consumer credit) and derivatives).
- There would be an 'opt-out' mechanism for retail clients who want to be treated as wholesale/sophisticated investors (but do not satisfy the relevant tests), provided that the licensee was satisfied that it was appropriate to treat the investor as wholesale and the investor acknowledged this designation of wholesale status by signing a written statement from the licensee.
- The laws on cross-endorsement of authorised representatives of insurers would be changed so that licensees would only be jointly and severally liable for their representatives' conduct where those representatives provided financial services in relation to the same sub-class of financial product. (This proposal seems to be restricted to life risk and general insurance.)

- The Australian Securities and Investments Commission (ASIC) has agreed to review the training standards contained in ASIC policy statement 146 Training of financial product advisers to ensure they are adequate (and also to take account of any changes that arise from the proposals paper (for example, the financial product sales recommendation proposal, referred to above)).
- The product disclosure statement (PDS) 'in-use' notice regime would be replaced with a new standardised reporting method which would require PDS issuers to complete a 'Financial Product Activity Report' within five days of preparing or modifying a PDS, or withdrawing or closing a financial product.
- The licensing exemption for dealing services provided by trustees of pooled superannuation trusts (PSTs) would be extended to the product disclosure rules applying to PSTs.
- The restriction in the Corporations Act on registered managed investment schemes (MISs) being able to invest in unregistered foreign MISs (subject to ASIC relief) would be amended to permit investment in unregistered MISs that operated predominantly outside Australia and were not operated by the responsible entity of the MIS or any of its associates.

The main corporate (non-FSR) proposals are as follows.

- Shareholders of public companies would have to request a hard copy of the company's annual report, with companies only being required to post a copy on their website for people to access. (Companies would however have to write to shareholders to let them know they may still receive a hard copy if required, and that copy would have to be provided free of charge.) This proposal would also apply to registered MISs and disclosing entities.
- The thresholds for determining whether a proprietary company is 'large' (and, therefore, required to prepare and lodge an audited financial report) would be increased and the application of the tests would change. (This is intended to ensure that only companies which are economically significant would be caught by this requirement.)

- The fundraising requirements would, in some cases, be simplified (including, by aligning relevant requirements in Chapters 6D and 7):
 - a prospectus or PDS would not be required for rights issues for quoted securities and quoted financial products, although a 'cleansing notice' (based on the notice currently required for secondary sales) would need to be provided to the Australian Stock Exchange;
 - the scope of the relevant fundraising provisions applying to 'small-scale' offerings would be widened to make the relevant requirements for securities and financial products more consistent and also to enable more fundraisings to take advantage of less onerous disclosure obligations under an offer information statement;
 - unlisted company employee share schemes would generally be exempt from licensing, advertising and hawking restrictions and subject to simpler disclosure requirements;
 - the secondary sales disclosure provisions would be extended so that controllers would be covered (and would no longer need to seek specific ASIC relief); and
 - the replacement prospectus provisions would apply in relation to stapled securities to facilitate more consistent functioning of the disclosure provisions for these securities.
- The timeframes for breach reporting obligations under prudential legislation and the Corporations Act would be changed to allow more time for reporting some breaches (although breaches currently required to be reported immediately would still need to comply with that requirement). The consistency of reporting requirements is to be considered in a separate proposals paper.
- Licensees would not have to cite their licence number in disclosure documents and other relevant documents but would only be required to cite their ABN and state that they are an Australian financial services licensee. (This proposal would be implemented once the required changes were made to the ABN database to allow customers to trace the licence number using that database.)

OTHER MATTERS

Other matters included are:

- streamlining the disclosure requirements applying to all non-cash payment facilities not related to basic deposit products;
- refinement of other company reporting obligations (including removing duplication in the executive remuneration disclosure requirements);
- measures to clarify and simplify auditor independence obligations under the Corporations Act;
- measures to ensure appropriate overseeing of market operators who were, or are, related to licensed participants;
- a limited review of the related party approval process;
- removal of telephone monitoring during takeover bids and a new proposal to remove the requirement to disclose a holding of 85 per cent (or more) in a company (ie, deletion of sections 665D and 665E of the Corporations Act notice provisions); and
- facilitation of electronic registration of charges over company property and associated documents.

WHAT IS NO LONGER BEING CONSIDERED

Two topics canvassed in the consultation paper will now no longer be part of the consultation process.

- The consultation paper considered whether it would be appropriate to reduce the length of concise reports required under the Corporations Act for distribution to shareholders (in place of the full annual report) and, if so, what summary information should be included in the concise report. Given the Government is now proposing to introduce electronic distribution of annual reports (proposal 2.8 – refer to our table for more details) allowing companies, registered schemes and disclosing entities to make their annual reports available on their website and only send hard copies to shareholders who request them, the Government considers it unnecessary to proceed with the earlier proposal.

- The consultation paper raised whether to allow lodgment of summary financial information relating to the parent entity when a corporate group lodges consolidated financial statements. The Government has decided not to proceed with this issue because the consultation process did not show that the costs of preparing this information outweighed the existing benefits to users.

The consultation paper and proposed categories list also identified a specific topic on how best to enhance communication between business, consumers and ASIC. It has not been separately addressed as a specific proposal in the proposals paper. It is however an objective of some of the proposals outlined in the proposals paper (particularly the compliance proposals).

Further, the proposals do not really address a major current area of concern – to ensure that consumers receive appropriate and independent advice. (The Government believes that the new ‘financial product sales recommendation’ distinction could help in this regard. However, there are several related issues that need to be considered in more detail, for example, remuneration of advisers and management of conflicts of interest. These are much bigger challenges for the Government and the regulators and probably do not have easy answers. Perhaps it is better that the Government has not really tried to tackle these more difficult issues.)

CONSULTATION PROCESS AND TIMETABLE

The Government has invited written submissions on its proposals by 22 December 2006. Following this short consultation period, the Government intends to release the proposed legislation in draft by February 2007, with the aim of it being passed before the next federal election.

In the meantime, we understand that the Government will shortly be releasing draft Regulations dealing with issues not covered by the proposals paper.

We will keep you informed of the main developments as they unfold.

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