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HOUSE OF REPRESENTATIVES

FINANCIAL SERVICES REFORM BILL 2001

EXPLANATORY MEMORANDUM

(Circulated by authority of the Minister for Financial Services & Regulation,
the Hon Joe Hockey, MP)

39202

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Outline

1.1 The Financial Services Reform Bill (FSR Bill) is the culmination of an extensive reform program examining current regulatory requirements applying to the financial services industry. In particular, the draft Bill provides the legislative response to a number of recommendations of the Financial System Inquiry (FSI).

1.2 The FSI was a comprehensive stocktake of Australia's financial system structure and regulation. The broad policy direction for what were known as the CLERP 6 reforms, now contained in the FSR Bill, is consistent with the findings of the FSI.

1.3 The FSI found that financial system regulation was piecemeal and varied, and was determined according to the particular industry and the product being provided. This was seen as inefficient, as giving rise to opportunities for regulatory arbitrage, and in some cases leading to regulatory overlap and confusion.

1.4 To address these deficiencies, the FSI proposed that there be a single licensing regime for financial sales, advice and dealings in relation to financial products, consistent and comparable financial product disclosure, and a single authorisation procedure for financial exchanges and clearing and settlement facilities.

1.5 The FSR Bill implements these proposals, and will put in place a competitively neutral regulatory system which benefits participants in the industry by providing more uniform regulation, reducing administrative and compliance costs, and removing unnecessary distinctions between products. In addition, it will give consumers a more consistent framework of consumer protection in which to make their financial decisions. The Bill will therefore facilitate innovation and promote business, while at the same time ensuring adequate levels of consumer protection and market integrity.

1.6 The proposed regulatory framework covers a wide range of financial products including securities, derivatives, general and life insurance, superannuation, deposit accounts and means of payment facilities. The requirements will apply to the activities of existing financial intermediaries such as insurance agents and brokers, securities advisers and dealers, and futures brokers, as well as any other person carrying on a financial services business.

1.7 The FSR Bill will also put in place a simplified authorisation process for market operators and clearing and settlement facilities. The new regulatory regime provides a flexible and adaptable framework that encourages innovation and competition in markets and clearing and settlement facilities.

1.8 An extensive public consultation process has been engaged in to produce the FSR Bill through the release of:

- a position paper, *Financial Markets and Investment Products,* in December 1997;
- a Consultation Paper, *Financial Products, Service Providers and Markets – An Integrated Framework,* in March 1999; and
- an exposure draft FSR Bill and accompanying commentary, in February 2000.

1.9 These consultations provided valuable feedback on the reform proposals, and were integral to the development of the FSR Bill.

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Regulation impact statement

Background to proposed amendments

Financial System Inquiry

2.1 The financial sector is undergoing rapid change and development, resulting in concerns about whether existing regulation remains adequate. The FSI was established in 1996 to analyse the forces driving change in the financial system, and to recommend ways to improve current regulatory arrangements.

2.2 The FSI found that the three major forces driving change were changing customer needs (including changing demographics and an increased willingness to adopt technology), technology driven innovation, and significant regulatory change, such as the liberalisation of trade and capital.[1] The Report then identified four broad changes arising from these forces: increased competition, resulting in rationalisation of pricing and costs; closer links between the Australian economy and international markets; increased conglomeration and further market widening, which would continue to challenge traditional institutional and regulatory boundaries; and increasing disintermediation in the provision of financial services.[2]

2.3 The Report also considered the philosophy behind financial regulation, and concluded that specialised regulation was required to ensure that market participants acted with integrity and that consumers were protected. This was so due to the complexity of financial products, the adverse consequences of breaching financial promises and the need for low-cost means to resolve disputes.[3] The principles of regulation which guided the inquiry were competitive neutrality, cost effectiveness, transparency, flexibility and accountability.[4]

2.4 The FSI considered that very large efficiency gains and cost savings could be released from the existing system through improvement to the regulatory framework and through continuing developments in technology and innovation. However, markets could only deliver these outcomes where competition was allowed to thrive and where consumers had confidence in the integrity and safety of the system.

2.5 The FSI did not advocate change for its own sake, but sought an appropriate balance between achieving competitive outcomes and ensuring financial safety and market integrity. In particular, the recommendations of the FSI sought to:

1 FSI, Final Report, p75.
2 FSI, Final Report, p137-8.
3 FSI, Final Report, p175
4 FSI, Final Report, p176.

- create a flexible regulatory structure which would be more responsive to the forces for change operating on the financial system;
- clarify regulatory goals;
- increase the accountability of the agencies charged with meeting those goals;
- ensure that regulation of similar financial products was more consistent, and promoted competition by improving comparability;
- introduce greater competitive neutrality across the financial system;
- establish more contestable, efficient, and fair financial markets resulting in reduced costs to consumers;
- provide more effective regulation for financial conglomerates, which would also facilitate competition and efficiency; and
- facilitate the international competitiveness of the Australian financial system.

2.6 One key issue in achieving these outcomes was market conduct and disclosure in the financial system. The FSI stated that financial markets could not work well unless participants acted with integrity, and there was adequate disclosure to facilitate informed decision-making by the consumers of financial products. The FSI identified the following problems with the existing regulatory approach[5]:

Disclosure

- financial market participants faced a range of information disclosure rules which varied greatly in their status, degree of prescription and penalties for breach;[6]
- the existence of widespread concerns that the information available did not allow prospective purchasers to compare products – consumers need to compare product characteristics, costs and expected rates of return if they are to make informed decisions;

Licensing

- regulatory arrangements involved complex and overlapping regulation of financial market participants, with particular problems where participants are subject to more than one regime, sometimes with contradictory rules;[7]

Financial markets

- incomplete coverage by the existing Corporations Law, which did not apply to transactions falling outside strict definitions of ‘securities’ or a ‘futures contract’;
- the narrow definitions of ‘securities’ and ‘futures contract’ required legislative amendments to permit exchanges to trade new products; and
- uncertainty and inconsistency in the treatment of hybrid products with both security and derivatives characteristics.

5 Only findings relevant to the FSR Bill are outlined here.
6 FSI, Final Report, p261.
7 FSI, Final Report, p271.

2.7 The Report therefore recommended[8] that:

- a consistent and comprehensive disclosure regime for the whole financial system be established, based on product profile statements which provided a better balance between effectiveness and cost;[9]

- a single licensing regime be introduced for all advisers providing investment advice and dealing in financial markets;[10]

- a single set of conduct requirements be developed for investment sales and advice including minimum standards of competency and ethical behaviour, requirements for the disclosure of fees, and rules for handling client property and money;[11]

- that the law covering financial markets adopt a broad definition of 'financial products' subject to generic requirements and supplemented by specific regulation for particular classes of products – to replace existing separate Corporations Law regulation of securities and futures contracts;[12] and

- that there be a single authorisation procedure for financial exchanges.[13]

Corporate Law Economic Reform Program (CLERP)

2.8 In tandem with the FSI, the Government established CLERP to review existing policy in key areas of business regulation. The purpose of the program is to ensure that current regulation is consistent with the government's economic objectives. In particular, it seeks to improve the efficiency of corporate regulation and reduce regulatory burdens on business. The reforms are aimed at facilitating a more efficient and competitive business environment.

2.9 Under this program, the Government released policy papers containing detailed proposals and draft legislative provisions as a means of consulting widely. CLERP Paper No. 6 dealt specifically with the financial system, and sought to implement the recommendations of the FSI. This paper was published in December 1997[14], followed by a consultation paper in March 1999[15]. The changes proposed by CLERP 6 are now embodied in the FSR Bill.

2.10 The FSR Bill also includes a 15 per cent limit on shareholdings in prescribed markets or clearing and settlement facilities, and a requirement for bidders and target companies involved in major takeovers to record telephone conversations with target shareholders. These reforms were not part of the public consultation process associated with CLERP 6.

The Financial System

2.11 The stability, integrity and efficiency of the financial system are critical to the performance of the entire economy.[16] Australia's strong and growing finance and insurance industry adds value through financial intermediation and support services, and is a significant employer in Australia.

8 As relevant to the FSR Bill.
9 Recommendations 8 and 9.
10 Recommendation 13.
11 Recommendation 15.
12 Recommendation 19.
13 Recommendation 21.
14 Financial Markets and Investment Products.
15 Financial Products, Service Providers and Markets – An Integrated Framework: Consultation Paper.
16 FSI, Final Report, p1.

Over each of the last six years, in current price terms, the finance and insurance industry has grown more quickly than the economy as a whole and, in 1999-2000, both year on year growth and through year growth for this industry were much higher than for Australia as a whole.[17] In 1999-00 the finance and insurance sector contributed 7.2 per cent to GDP, up from 6.8 per cent in 1998-99. The finance and insurance sector is the fourth largest sector in the Australian economy, and is larger than both agriculture (3.3 per cent) and mining (4.6 per cent) sectors.[18]

2.12 The financial sector is made up of the following: the central bank and prudential regulatory bodies; depository corporations (such as banks, building societies and credit co-operatives); insurance corporations and pension funds (life insurance, general insurance, superannuation funds); other financial corporations, including financial intermediaries (such as financial unit trusts and investment companies); and financial auxiliaries (such as securities brokers, insurance brokers and flotation corporations).[19]

2.13 As at 30 June 2000, the consolidated total financial assets on the books of financial institutions was $1,389.4 billion.[20] The total assets on the books of Australian banks (excluding the Reserve Bank of Australia (RBA)) at the same date were $731 billion.[21] Life insurance corporations held total assets of $184 billion as at 30 June 2000, while general insurance corporations held assets of $68 billion.[22] Superannuation funds had total assets of $405 billion as at 30 June 2000.[23] Managed funds had consolidated total assets of $590,422 million as at 30 June 2000.[24] Turnover on the Sydney Futures Exchange (SFE) in 1999-00 was $10.03 trillion, up from $6.2 trillion in 1993-94.[25] At the end of June 2000, the market capitalisation of domestic equities on the Australian Stock Exchange (ASX) was $682 billion, up from $163 billion in 1988-89, and the market capitalisation of overseas-based equities on the ASX (at the end of June 2000) was $210 billion.[26]

2.14 The following Acts currently regulate the financial sector:

2.15 Corporations Law and regulations (which will be replaced by the proposed *Corporations Act 2001* (proposed Corporations Act) and regulations);

2.16 *Australian Securities and Investments Commission Act 1989* (ASIC Act) and regulations (which will be replaced by the proposed *Australian Securities and Investments Commission Act 2001* (proposed ASIC Act) and regulations);

Banking Act 1959;

Insurance Act 1973;

Insurance (Agents and Brokers) Act 1984 and regulations;

Insurance Contracts Act 1984;

Life Insurance Act 1995;

17 ABS, Finance Australia 1999-2000, p25.
18 AFMA Annual Report; ABS, Australian National Accounts (National Income, Expenditure and Product), Table 38.
19 ABS, Finance Australia 1999, p11.
20 ABS, Finance Australia 1999-2000, p27.
21 ABS, Finance Australia 1999-2000, p29.
22 ABS, Finance Australia 1999-2000, pp33 and 36.
23 ABS, Finance Australia 1999-2000, p35.
24 ABS, Finance Australia 1999-2000, p56.
25 Sydney Futures Exchange
26 Australian Stock Exchange.

Retirement Savings Accounts Act 1997;

Superannuation Industry (Supervision) Act 1993.

Consultation

2.17 The Government established the Business Regulation Advisory Group (BRAG), which represents key stakeholder organisations, so that the CLERP proposals could be developed in close consultation with business. The Companies and Securities Advisory Committee (CASAC), which provides advice to the Government from the business and professional communities, also provided detailed comments on the proposals. There has been strong support from the business community for CLERP.

2.18 Following the release in March 1999 of the CLERP 6 Consultation Paper, an extensive public consultation process took place. The Minister for Financial Services and Regulation met with key stakeholders representing the interests of consumers, financial service providers and financial markets. In addition, Treasury and the Minister's office held public consultations in Sydney, Melbourne, Brisbane, Adelaide, Perth and Darwin, with over 400 interested parties. More than 120 submissions were received in response to the Paper, and officers of the Treasury have participated in over 80 meetings with stakeholders.

2.19 The consultation process in relation to the draft FSR Bill commenced upon the release of the Bill to the public on 11 February 2000. Treasury received over 100 submissions in response. Targeted consultation sessions with stakeholders were conducted in April 2000, and representatives from approximately 30 interest groups attended these sessions. Feedback from stakeholders represented at the round-table consultations was largely positive, although a number of refinements to the draft legislation were suggested. These suggestions have been taken into account in the final drafting of the FSR Bill.

Problem identification and regulatory objectives

2.20 Regulation in this area can be justified from a market failure perspective. The FSI identifies the market failures, and these are summarised above, along with the relevant recommendations of the Inquiry. The objectives of the FSI review were to develop a regulatory framework that is consistent, flexible, adaptable and cost effective.[27]

2.21 CLERP is also aimed at improving the efficiency of the regulatory environment, reducing costs on business and industry participants, and removing barriers to entry for service providers. CLERP 6, now embodied in the FSR Bill, is intended to achieve these objectives in relation to the financial sector.

2.22 The following section details more specific problems with existing regulation and the solutions proposed by the Government in the FSR Bill. The proposed solutions follow very closely the recommendations of the FSI.

2.23 However, the 15 per cent shareholding limit in prescribed markets or clearing and settlement facilities, and the requirement for bidders and target companies involved in major takeovers to record telephone conversations with target shareholders, both now included in the FSR Bill, did not originate in the recommendations of the FSI.

27 See discussion of FSI above, paras 1-7.

Overview of FSR Bill

2.24 The FSR Bill was originally intended to amend the existing Corporations Law. However, the High Court's decision in the Hughes case last year questioned the constitutional basis for aspects of the existing Corporations Law. Agreement was reached with New South Wales and Victoria late last year on a referral of power to address the constitutional uncertainty. Once the necessary legislation is in place, the Commonwealth will be able to introduce the Corporations Bill 2001. The FSR Bill will then amend the proposed Corporations Act. This Regulatory Impact Statement (RIS) will therefore refer to the proposed Corporations Act, where appropriate.

2.25 The three key elements of the regime proposed in the FSR Bill are:

- product disclosure;
- licensing and conduct of financial services providers; and
- licensing of financial markets and clearing and settlement facilities.

2.26 These features are explained in greater detail below. However, they all rely on a new definition of 'financial product', which replaces definitions in existing consumer protection legislation for securities, futures, insurance, superannuation, some banking products, and managed investments. The new definition is designed to be flexible, and starts with a general definition that focuses on three key functions provided by financial products, namely making a financial investment, managing a financial risk, and making non-cash payments. There is also a list of specific inclusions in the definition, and a list of specific exclusions. A regulation-making power provides further flexibility to include or exclude particular products from the regime as appropriate. This power will ensure the continuing relevance of the legislation as new financial products emerge.

2.27 Another key definition is that of 'retail client'. The FSR Bill draws a distinction between retail and wholesale clients. Generally, the consumer protection provisions will apply only to retail clients, as it is recognised that wholesale clients do not require the same level of protection, as they are better informed and better able to assess the risks involved in financial transactions. The new definition of 'retail client' has several limbs.

2.28 The first limb applies only to general insurance, and is product based. An individual or small business that purchases or receives advice on one of the listed general insurance policies will be considered a retail client. The list is based primarily on the concept of 'standard cover' in the *Insurance Contracts Act 1984* (Insurance Contracts Act), plus a couple of additional categories of policies also regarded by industry as 'consumer' policies. A regulation-making power is included for flexibility. General insurance is treated differently from other financial products for two reasons. First, it is difficult to identify a meaningful monetary limit for insurance, as either the premium or sum insured could be used. Secondly, if the premium were relied upon, few (if any) policies would exceed the product-value test outlined below, with the result that all purchasers of general insurance policies would be retail clients. It is not desirable from a policy perspective to capture wholesale products, such as marine insurance and property insurance for businesses, which are also general insurance products. Such an approach would also be inconsistent with the concept of consumer insurance policies in existing insurance legislation.

2.29 The second limb provides that a person will always be considered a retail client where the relevant financial product is a superannuation product or a retirement savings account (RSA). This will ensure that disclosure is given to all persons in relation to superannuation and RSA products. This is consistent with the long term nature and complexity of such products and will ensure the integrity of the regime in a choice of superannuation fund environment.

2.30 The third provision relates to all financial products except general insurance, superannuation and RSAs, and comprises four tests. The product-value test provides that a person is not a retail client where they purchase a financial product, or a financial service related to a financial product, and the value of the product is above the prescribed threshold (to be set initially at $500,000). Regulations may modify the application of the test where appropriate. The second test ensures that small businesses receive protection as retail clients under the regime. The third test considers individual wealth and provides that a person with net assets of at least $2.5 million or a person who had a gross income for each of the last two financial years of $250,000 or more will not be considered retail. Finally, professional investors are always considered wholesale clients. This category includes financial services professionals, listed entities, banks and friendly societies, and other entities that may be presumed to have the expertise and/or access to professional advice to justify their being treated as wholesale.

Financial product disclosure

Problems/options

2.30 There are two major problems with existing regulation of financial product disclosure. First, functionally similar products are governed by disparate Acts and non-legislative instruments. In particular:

- securities, futures and managed investments are covered by the proposed Corporations Act;
- insurance is governed by the Insurance Contracts Act and codes of practice;
- superannuation is governed by the *Superannuation Industry (Supervision) Act 1993* (SIS Act); and
- many retail banking products are subject to the Code of Banking Practice.

2.31 These instruments impose differing levels of disclosure in relation to the various products. It is therefore very difficult for consumers to compare different, but functionally similar, financial products.

2.32 Secondly, developments in the financial services industry have led to organisations now offering a range of financial products and services in relation to those products. The fragmented and product-specific nature of the existing legislation is hampering this development by imposing inconsistent standards and high compliance costs.

2.33 The proposed solution is to apply consistent disclosure requirements to all ‘financial products’, although with flexibility in the legislation to allow for significant differences between products. The requirements comprise point of sale disclosure through a Product Disclosure Statement, ongoing disclosure and periodic reporting requirements, advertising requirements, and an obligation to provide confirmation of transactions.

2.34 This disclosure regime will replace a range of existing disclosure regimes for financial products, such as those under the SIS Act and regulations, the *Retirement Savings Accounts Act 1997* (RSA Act) and regulations, life insurance circulars, codes of practice governing deposit-taking institutions, and existing Corporations Law requirements for managed investments and futures. The new regime will also supplement, but not replace, requirements under the Insurance Contracts Act.

2.35 The new disclosure requirements will generally only apply to dealings with retail clients.

Costs/benefits

2.36 Industry will benefit from the introduction of consistent disclosure standards. Many entities that now offer several financial products, currently subject to different regulatory regimes, will benefit from having the same disclosure requirements apply to all products. This will ultimately decrease compliance costs, although industry will probably incur some costs in the initial stages associated with preparing the new disclosure documents required under the new regime. These costs are difficult to quantify and will vary between different product issuers. However, costs will be limited by the fact that the new disclosure regime is broadly in line with existing industry legislation, codes and practice. Further cost minimisation is assisted by transitional provisions which allow product issuers up to two years in which to move to the new regime. Most product issuers would need to update their disclosure documents over that two year period in any event as, under a number of existing regimes, existing disclosure documentation has a mandated shelf life of around 12 months. For example, life insurance disclosure documents must be updated every 12 months, the key features statement for superannuation funds is only current for 12 months, and prospectuses for managed investments last for 13 months.

2.37 Consumers will benefit from the new regime, as a consistent standard of disclosure will allow consumers to compare functionally equivalent financial products, and lead to increased consumer confidence and participation in the financial sector.

Feedback from consultations

2.38 Submissions are generally supportive of consistent disclosure standards, although there has been debate over the role of industry codes under the new regime. These comments have been taken into account in refining the FSR Bill.

Conclusion

2.39 The introduction of a consistent disclosure standard to apply to all financial products addresses consumers' need for comparable information on products, while increasing industry efficiency and lowering compliance costs.

Licensing and conduct of providers of financial services

Problems/options

2.40 As with financial product disclosure, existing regulation of providers of financial services is product-specific and contained in a number of different Acts and non-legislative instruments. Again, this creates problems in a sector that is rapidly consolidating, where banks now offer stockbroking services and financial advisers provide advice on a broad range of financial products. These entities are obliged to obtain multiple licences and to comply with a range of legislation and non-legislative instruments that may be inconsistent in conduct and disclosure standards. Potential competitors are discouraged from entering the market by these complexities, and those involved in offering a range of services and products incur high compliance costs and an increased administrative burden.

2.41 Consumers are also disadvantaged by the current regulatory framework as they cannot be certain that the conduct of the financial service provider meets minimum standards. Consumers

may also be confused by persons acting in several capacities, and therefore holding several licences. Further, consumers may not receive sufficient information in relation to certain matters, such as commissions on products.

2.42 The proposed solution is to introduce a single licensing regime applying to all persons providing a financial service, whether as principals or as authorised representatives. 'Financial services' is defined in the FSR Bill as providing advice, dealing in, or making a market in financial products; operating a managed investment scheme; or providing a custodial or depository service.

2.43 The financial service provider and authorised representatives provisions will apply to the following classes of existing participants:

- securities dealers and investment advisers;
- futures brokers;
- life insurance companies, general insurance companies;
- superannuation funds;
- life and general insurance brokers;
- deposit taking institutions; and
- their agents and employees.

2.44 The single licensing regime will therefore replace licensing requirements in the:

- Proposed Corporations Act — applying to securities dealers, investment advisers, futures brokers and futures advisers, and their proper authority holders;
- *Insurance (Agents and Brokers) Act 1984* (IABA) — providing for the registration of general insurance and life insurance brokers and the regulation of insurance agents; and
- Banking (Foreign Exchange) Regulations — applying to foreign exchange dealers.

2.45 The single licensing regime will also apply to product issuers (such as life insurance companies, friendly societies, general insurance companies, banks, superannuation funds) who carry on a financial services business and who:

- engage agents to provide advice on and/or sell products to clients;
- sell products directly to clients through direct response campaigns (irrespective of the medium through which these transactions occur, for example, direct mail campaigns, telephone sales or internet sales); or
- sell products directly to clients 'over the counter'.

2.46 Provisions in current insurance and superannuation regimes and the relevant parts of the SIS Act and the IABA will be repealed. In addition, the licensing provisions in Chapters 7 and 8 of the proposed Corporations Act will be replaced by these new provisions.

2.47 A licence will be required where services are provided to either wholesale or retail clients. Consistent conduct and disclosure standards will then apply to all licensees, but with some flexibility to tailor requirements to different services, and with additional obligations placed on

licensees who provide services to retail clients. Examples of the conduct standards imposed on licensees include: a requirement to provide financial services in a competent and honest way; a requirement to comply with any conditions imposed by the Australian Securities & Investments Commission (ASIC) on the licence; obligations in respect of the handling of clients' funds; and an obligation to maintain competence, skills and experience to provide financial services.

Costs/benefits

2.48 Industry will benefit from the new licensing regime in several ways. Both compliance costs and the administrative burden relating to conduct and disclosure will be reduced due to the new uniform standards, particularly for entities that offer several different financial services and would have required multiple licences under existing regulation. An example is life insurance advisers who also advise on or deal in securities, who are currently required to comply with requirements under both the insurance and securities regimes. This requires the adviser to be either a licensed securities dealer or proper authority holder under the existing Corporations Law and either a registered life insurance broker or life insurance agent under the life insurance regime.

2.49 However, there will be some costs associated with the move to the new licensing regime, although these are difficult to quantify. In particular, industry may incur costs in bringing their conduct and disclosure practices in line with the new regime, although in many instances the new requirements mirror or build on existing requirements in legislation or industry codes. The regime provides for a two year transitional period, which should also assist in the reduction of compliance costs. In fact, the submission from the Investment & Financial Services Association Ltd concludes that the FSR Bill will have a positive impact on the costs associated with the licensing and distribution of financial services.[28]

2.50 The simplified procedures will also increase competition in the financial services sector, by encouraging existing participants to broaden the range of products and services offered by them to the public. Consumers will benefit from the increase in competition, through lower costs and a greater range of products and services, and from the more thorough conduct and disclosure regime. There will also be reduced risk of confusion due to participants holding several different licences to act in different capacities.

Feedback from consultations

2.51 Market participants generally support the introduction of a single licensing regime, recognising the benefits it will provide to industry.

Conclusion

2.52 In order to increase efficiency and competition, and to decrease the regulatory burden on providers of financial services, a single licensing regime will apply to providers of financial services.

28 Submission dated 27 April 2000, p3.

Markets and clearing and settlement facilities

Problems/options

2.53 The primary problem in relation to Australian markets is the lack of competition in this sector, for the reasons outlined below.

2.54 Currently, there are only two approved securities exchanges operating in Australia — the ASX and the Stock Exchange of Newcastle Limited — and two approved futures exchanges — the SFE and the Australian Derivatives Exchange Limited. Similarly, there are only two approved clearing houses[29], the Securities Clearing House (SCH), which is associated with the ASX and is expressly recognised in the proposed Corporations Act, and the SFE Clearing House.

2.55 The problems in respect of exchanges arise largely from the distinction made in the proposed Corporations Act between securities and futures, which are currently regulated in separate Chapters. There are some inconsistencies between the two regimes as they were written at different times, and as separate Acts, prior to being included in the existing Corporations Law. Under existing law, exchanges can trade in only securities or futures contracts. The licensing regime is also complicated, as there are seven avenues of authorisation for operating a securities or futures market. Further, the distinction between securities and futures has become unsustainable due to the emergence of financial products bearing features of both securities and futures, which are very difficult to categorise as one or the other. Such products must currently be categorised as one or the other by means of regulations, which is complicated and cumbersome. Current arrangements therefore allow scope for regulatory arbitrage.

2.56 Competition in relation to clearing and settlement facilities is discouraged by the significant advantages conferred on the SCH under the existing provisions, such as its unique access to provisions which facilitate electronic transfer of legal title. While a person is not prevented from offering a competing service, the advantages enjoyed by the SCH would make the new facility uncompetitive in practice.

Costs/benefits

2.57 The Government aims, with the new regulatory regime, to increase competition in these areas by lowering the barriers to entry and encouraging new participants to operate competing markets and facilities. First, the new regime ends the current distinction between securities exchanges and futures exchanges by introducing a single licensing regime for ‘financial markets’. The single licensing regime will replace the seven avenues for authorisation as operators of various financial markets under the proposed Corporations Act. This will greatly simplify licensing procedures. Further, a suitably qualified market will be able to trade in any financial product, and in particular both securities and derivatives.

2.58 The new regime will enhance competition in respect of clearing and settlement facilities by extending the ability to carry out electronic transfers of trades to all prescribed facilities, ending the SCH competitive advantage in this regard.

2.59 The new regulatory framework is not intended to increase regulation, but will harmonise the legislation relating to securities and futures contracts.

29 It is through a clearing and settlement facility that the participants to a transaction perform the obligations which that transaction involves. In the case of a facility which handles securities transactions, this will involve the exchange of payment for 'delivery' of the securities; in the case of futures transactions, the facility will also maintain a continuous record of futures market trading. Facilities may be owned by an exchange or be independent of any exchange.

2.60 The new regime also facilitates the participation of overseas markets and facilities in Australia. The Minister will be able to grant a licence to operate a market or facility in Australia, to the operator of an overseas market or facility where the operator satisfies certain criteria, such as being subject to a regulatory regime at least equivalent to that in Australia, and undertaking to co-operate with ASIC. Again, this measure should enhance competition by removing barriers to the entry of overseas facilities.

Feedback from consultations

2.61 Feedback on the proposals relating to markets and clearing and settlement facilities was largely positive, although some refinements were suggested. These have been taken into account in the drafting process, and modifications made where appropriate.

Conclusion

2.62 Competition will be greatly facilitated by the ending of the distinction between securities and futures contracts, by the extension of electronic transfer and title provisions to any prescribed clearing and settlement facility, and by the greater participation of overseas markets and facilities in Australia.

Problem/options

2.63 Another problem in relation to financial markets and clearing and settlement facilities is the 5 per cent shareholding limitation that currently applies to the ASX. The shareholding limitation, inserted when the ASX demutualised in 1998, by applying only to the ASX, does not provide regulatory neutrality, limits the manner in which the ASX can enter into partnerships with overseas exchanges, entrenches management control and lessens pressure for accountability to shareholders. Rigid ownership controls have the potential to weaken apparently strong existing market operators, such as the ASX, by making it difficult or slow to restructure to take advantage of strategic partnerships or otherwise adapt to changing circumstances (such as advent of the Internet). This problem was not identified in the FSI.

2.64 It is therefore proposed that shareholdings in prescribed markets or clearing and settlement facilities under the proposed Corporations Act be subject to a 15 per cent limit. Further, a person may apply in respect of their shareholding in a prescribed entity to the Minister for approval of a percentage limit higher than 15 per cent. Consideration of an application by the Minister will be separate from the licensing procedures in respect of markets and clearing and settlement facilities and approval will depend on the Minister deciding that holding a higher percentage of the voting power would be in the national interest.

2.65 This licensing regime will include a probity check requirement in the form of a 'fit and proper person' test for persons involved in the management or control of a market or clearing and settlement facility. This test will apply to persons, who directly or through corporate entities, control 15 per cent of the voting shares (including shares held by associates); and persons who are the directors, secretary and executive officer of a company which operates a financial market or a clearing and settlement facility.

2.66 A person would not be 'fit and proper' if he or she is disqualified from managing a corporation under section 206B of the proposed Corporations Act; their name appears on the register kept by ASIC for the purposes of section 1274AA (persons whom a Court or ASIC has ordered not to manage a corporation); he or she has been declared by ASIC not to be fit and proper after notice has been given by ASIC, a hearing conducted and a report made to it (ASIC would make such a

decision on a case by case basis). Decisions of ASIC are subject to review by the Administrative Appeals Tribunal.

2.67 Another option in relation to the shareholding limitation is self-regulation. However, a self-regulatory approach is likely to be criticised as lacking public transparency and accountability and leaving the integrity of Australia's prime securities markets and clearing and settlement facilities to decisions of the market or facility itself which clearly has limits on its ability to take action to prevent a particular party from gaining control. Legislation is required to put a limitation on the acquisition of shares and to give time for an assessment of the acquirer to occur. Quasi-regulation and co-regulation also appear unsuitable for similar reasons.

Costs/benefits

2.68 The proposal will involve some minor costs to the relevant financial markets and clearing and settlement facilities (including the ASX) in providing additional information to the Minister. It is not expected to have any significant cost to ordinary shareholders. Substantial shareholders may incur some minor additional costs in disclosing the required information and run the risk of being unable to obtain a larger shareholding. The ASX management may be disadvantaged by the proposal as it would lose some of the protection afforded by the current fixed shareholding limitation (but directors who hold significant parcels of shares in the ASX may benefit from an increase in their value). The cost to government of the proposal is considered to be negligible, and no additional funds are sought from Consolidated Revenue.

2.69 The benefits of the proposal are significant. The proposed amendment is regulatory neutral and will improve competition. The ASX will benefit as a flexible ownership limitation will allow it to adapt to the rapidly changing environment in which it is operating. It is undesirable that the ASX be subject to limitations not imposed on its competitors, in an era of increased competition when particularly wholesale investors can, in many instances, easily arrange for their instructions to be executed through overseas markets which are evolving rapidly. The possibility of persons acquiring more than a 15 per cent shareholding will subject the ASX management to increased business pressures to perform. This is likely to result in a more competitive and efficient market, with advantages for participants and shareholders. ASX shareholders may also be advantaged by implementation of the proposal as it is expected that the current fixed limitation has a downward effect on the price of the shares in the ASX.

2.70 The shareholding limitation provides an appropriate safeguard to the national interest. It will be possible to stop a dominant shareholder emerging if this were not in the national interest. Otherwise, the cost to the community of an unscrupulous operator gaining control of prescribed entity could be high, as it would present a serious threat to market participants and cause significant damage to Australia's international reputation for fair and orderly financial markets.

Feedback from consultations

2.71 The ASX opposes retention of the current 5 per cent limitation.

Conclusion

2.72 The increase in the ownership limitation from 5 per cent to 15 per cent (with the ability to increase this limit with approval of the Minister), and its application to other prescribed entities regulated under the proposed Corporations Act will provide commercial flexibility in a rapidly changing competitive environment while ensuring the national interest is preserved.

2.73 The 'fit and proper' test will provide assurance that only persons of probity are involved in the management and control of financial markets and clearing and settlement facilities and assist in maintaining the reputation and confidence in Australia's markets.

Market Misconduct

Problems/options

2.74 Existing market misconduct provisions cover market manipulation, false trading and market rigging, dissemination of information about illegal transactions, false and misleading statements, and fraudulently inducing persons to deal. There are currently two sets of provisions — one for securities and one for futures contracts. As discussed above, the FSR Bill ends the legislative distinction between securities and futures contracts. Moreover, the two sets of provisions were drafted at different times and are inconsistent in some respects.

2.75 A similar problem arises in relation to existing insider trading provisions. These are contained in Chapters 7 and 8 of the proposed Corporations Act, and in the SIS Act. Again, the provisions are not entirely consistent in their application to the different financial products.

2.76 Further, the general market misconduct provisions and the insider trading provisions do not apply to all financial products that may be traded on a financial market. This leaves open the possibility that the same conduct may be an offence only in relation to certain financial products. This is undesirable from a policy perspective, and contrary to the aim of the FSR Bill to regulate functionally similar financial products in a consistent manner.

2.77 It is therefore proposed to consolidate the different sets of provisions, and then extend the single set of provisions to cover all financial products that may be traded on a financial market. In light of the changes that will be made by the FSR Bill, there does not appear to be any other viable option but to amend the market misconduct and insider trading provisions as proposed above.

2.78 Another major problem that exists in relation to the market misconduct and insider trading provisions, is the difficulty ASIC has in successfully prosecuting a breach of the provisions. As the existing provisions are offence provisions, the criminal burden of proof (beyond reasonable doubt) applies. ASIC has found it difficult to prove elements of the offences beyond reasonable doubt, as many elements refer to the defendant's state of mind. This difficulty may result in cases not being pursued even where there has been a breach of the provisions. This is undesirable as it casts the law into disrepute, and also threatens the integrity of financial markets.

2.79 It is therefore proposed to make the market misconduct and insider trading provisions civil penalty provisions. The application of the civil burden of proof (balance of probabilities) will facilitate the bringing of actions for breaches of the provisions. The application of civil penalties is likely to act as a deterrent to market misconduct.

Another option is to redraft the offence provisions to make them easier to prosecute. However, significant objections to such a proposal may be anticipated given that criminal sanctions would apply to contraventions.

Costs/benefits

2.80 There are no obvious costs associated with the proposed changes.

2.81 Consumers and industry will benefit from the consistent regulation of functionally similar products, as they can be certain about the type of behaviour that is prohibited in relation to all relevant financial products.

2.82 The high reputation enjoyed by the Australian financial markets, and consumer confidence in the integrity of the markets, will benefit from the application of civil penalties to market misconduct and insider trading provisions.

Feedback from consultations

2.83 There were very few comments on the proposed changes to the market misconduct and insider trading provisions, and no objections to the proposal to make a single set of provisions apply to all financial products that may be traded on a financial market.

2.84 ASIC is very keen to have the market misconduct and insider trading provisions become civil penalty provisions, on the grounds that this will enhance its ability to safeguard the integrity of Australian financial markets.

Conclusion

2.85 The consolidation of the different sets of market misconduct and insider trading provisions, and their application to a broader range of financial products, is necessary in light of the changes brought about by the policy objectives of the FSR Bill.

2.86 Breaches of the market misconduct and insider trading provisions must be punished to ensure the integrity of Australian financial markets. ASIC's ability to enforce these provisions will be enhanced by making them part of the civil penalty regime.

Telephone monitoring

Problem/options

2.87 The use of the telephone to communicate with individual shareholders during major takeover bids is becoming commonplace. Professional communications consultants are often used by both the bidder and the target company to contact target company shareholders by telephone. There is the possibility that during these telephone conversations breaches of the proposed Corporations Act could take place, particularly in relation to misleading or deceptive conduct. However, it would currently be difficult to establish that such breaches had occurred as it is unlikely that either party would have a record of the conversation. This problem was not identified in the FSI.

2.88 It is proposed that the law be amended to require bidders and target companies to record telephone conversations with target shareholders. The policy objective is to provide a greater level of protection for small shareholders from these potential breaches of the proposed Corporations Act. It is proposed to insert new provisions into Chapter 6 of the proposed Corporations Act (in Division 5, Part 6.5) requiring the recording of these communications. The provisions will only apply to major takeovers, where the target company is either a listed company or an unlisted company with more than 50 members as these are these are the kinds of takeovers that are regulated under the proposed Corporations Act.

2.89 ASIC put forward an alternative proposal, under which bidders, target companies and their agents would be prohibited from communicating by telephone with target company shareholders during the course of a takeover bid, other than with the consent of ASIC. However, this proposal is

contrary to one of the basic principles of takeover regulation, that target company shareholders are given enough information to enable them to assess the merits of the bid.

Costs/benefits

2.90 If the proposed provisions are introduced, bidders and target companies will incur costs associated with the training of staff in the requirements of the new provisions, the provision of appropriate recording devices, and costs involved in identifying and storing recordings.

2.91 However, the provisions will benefit small shareholders by ensuring that bidders and target companies comply with the Law in their dealings with these shareholders. The provisions will also benefit the bidders and target companies by protecting them from costly legal disputes in the event of any accusation by shareholders of misleading and deceptive conduct arising from telephone canvassing.

Feedback from consultations

2.92 These provisions were not included in the exposure draft FSR Bill and therefore have not been subject to extensive public consultation. However, given the privacy implications, the Attorney-General's Department and the Federal Privacy Commissioner were consulted. The Privacy Commissioner has expressed concern that the proposed provisions have not been subject to public consultation, and has recommended the inclusion in the FSR Bill of an alternative method for providing shareholders with information if they do not wish to participate in a monitored telephone call, and a sunset clause subject to a trial period and review of the proposal. In relation to the second point, it should be noted that all shareholders are provided with the relevant takeover documents as required by existing takeover provisions. The telephone calls are generally not intended to provide further information, but to canvass the opinions of shareholders in relation to the proposed takeover.

2.93 ASIC was also consulted and advised that it currently deals with this potential problem by reviewing the scripts provided by bidders and target companies to telephone canvassers to make the relevant calls to shareholders. ASIC suggested several refinements to the proposed provisions that have been taken into account in the drafting process. As noted above, ASIC also put forward an alternative proposal that all telephone communications during a takeover bid be banned.

2.94 The telephone monitoring provisions were also forwarded to the BRAG and to the Ministerial Council on Corporations (MINCO) for their consideration. BRAG and MINCO have not commented on the proposed provisions.

Conclusion

2.95 As more Australians become shareholders, the risk that some shareholders will be misled or deceived by bidders or target companies during a takeover bid becomes greater. The most straightforward and cost effective means of dealing with this problem is to introduce the proposed provisions requiring the taping of all telephone conversations to shareholders initiated by bidders and target companies.

Implementation and review

2.96 The reforms are being implemented through changes to the proposed Corporations Act. The FSR Bill introduces a new Chapter 7 into the Act.

2.97 The reforms contained in the Bill will be reviewed after the two year transition period for their implementation. The review of the Bill's new licensing regimes will be conducted by Treasury and ASIC, and will assess the effectiveness of the associated administrative arrangements, and the longer-term resource requirements for ASIC in administering the licensing regimes. The new financial product disclosure regime will be reviewed by CASAC.

3

Financial impact statement

3.1 The FSR Bill will reduce compliance costs for industry through the introduction of consistent product disclosure obligations across all financial products regulated by the Bill. However, industry is likely to incur some costs in the initial stages associated with preparing the new disclosure documents required under the new regime. Costs will be limited by the fact that the new disclosure regime is broadly in line with existing requirements, and through transitional provisions which will permit a gradual adaptation to the new requirements.

3.2 The Bill will also reduce compliance costs in respect of licensing, conduct and disclosure requirements imposed on financial service providers, who will need only to satisfy the requirements of the Bill, rather than varying requirements imposed by a number of Acts. Industry may incur costs in satisfying the new licensing arrangements and in bringing their conduct and disclosure practices in line with the new regime, although the new requirements largely build on existing requirements. Again, transitional provisions should minimise costs to industry.

3.3 The Bill simplifies licensing procedures for financial markets and clearing and settlement facilities, thereby reducing compliance costs in this area also. These participants in the financial sector may incur minor additional costs in providing information required under the new 'fit and proper person' test.

3.4 The Bill will impose some costs on takeover targets and bidders affected by the telephone monitoring provisions, associated with staff training, provision of equipment, and information handling costs.

3.5 ASIC, as the regulatory body responsible for administering the new provisions, will incur some additional costs in the transition to the new regime.

4

Summary of key amendments proposed by the FSR Bill

4.1 A more efficient and flexible regime for financial markets and products will be achieved through an integrated regulatory framework for financial products. This will provide consistent regulation of functionally similar markets and products.

4.2 The new framework will apply to a range of existing financial products including:

- securities;
- derivatives;
- superannuation and retirement savings accounts;
- general and life insurance;
- deposit accounts;
- means of payment services such as smart cards and e-cash; and
- foreign exchange transactions other than pure money changing business.

4.3 Flexibility in the regulatory framework to accommodate new and innovative products will be provided through:

- a broad functional definition of financial product which will capture products without the need for legislative amendment; and
- the ability to exempt products via regulation or an ASIC exemption power.

4.4 The key elements of the regime applying to generally to this range of financial products are as follows.

Licensing of Financial Markets

4.5 A licence will be needed to operate a financial market:

- where financial products are regularly traded; and
- where transactions involve multiple buyers and sellers.

4.6 The criteria to be satisfied to obtain a licence to conduct a financial market will be broadly expressed and flexible enough to accommodate different market structures. The market operator must have:

- adequate arrangements for the supervision of the market;
- sufficient resources to conduct the market and provide for supervisory functions;
- adequate rules or procedures for the operation of the market, relating to, among other things, access to market facilities, participants' conduct and procedures for dealing with complaints; and
- in the case of markets on which the transactions of retail clients are effected, compensation arrangements for the benefit of those participants.

4.7 The legislation will set out the ongoing obligations which will be imposed on a market operator to ensure that the objectives of market regulation are satisfied on a continuing basis.

4.8 A market operator will be required to obtain a licence from the Minister to operate a financial market.

4.9 Stock and futures exchanges approved at the commencement of the new provisions will be deemed to be licensed as financial markets.

Licensing of Clearing and Settlement Facilities

4.10 A licence to operate a clearing and settlement facility will be required.

4.11 To obtain a licence to operate a clearing and settlement facility, the operator of the facility must have:

- adequate arrangements for the supervision of the facility;
- sufficient resources to conduct the facility and provide for supervisory functions; and
- adequate rules or procedures for the operation of the facility.

4.12 The legislation will impose ongoing obligations on the operator of the clearing and settlement facility to ensure that the objectives of their regulation are satisfied on a continuing basis.

4.13 The Minister will be empowered to license clearing and settlement facilities.

4.14 The legislative framework of the regime regulating clearing and settlement facilities largely mirrors that applying to financial markets, but the obligations imposed by that framework differ, reflecting the different services and risks provided by markets and clearing and settlement facilities.

4.15 Securities and futures clearing and settlement facilities approved under the proposed Corporations Act at the commencement of the new provisions will be deemed to be licensed under the new regime.

Limits on involvement with licensees

4.16 There will be a 15 per cent limitation on voting power in prescribed market licensees and clearing and settlement facility licensees (or their holding companies). The Minister, if satisfied that it is in the national interest, may approve a holding in excess of 15 per cent.

4.17 In addition, persons involved in all market licensees and clearing and settlement facility licensees will be subject to a 'fit and proper person' test administered by ASIC.

Compensation Arrangements for markets

4.18 Compensation arrangements protect participants against loss caused in defined circumstances during the execution of a market transaction.

4.19 Compensation arrangements are seen as critical to the confidence of retail participants.

4.20 Markets on which retail participants trade through financial service providers will be required to have compensation arrangements, at least in relation to fraud and negligence.

4.21 Financial markets will be entitled to call for contributions by participants for the compensation arrangements.

4.22 Criteria for the expenditure of (excess) funds in development accounts will be included in the regulations.

4.23 The National Guarantee Fund (NGF) will continue to be regulated separately, although the detailed provisions governing the requirements for claiming and procedure in relation to claims will be moved into the regulations.

Licensing of Financial Service Providers

4.24 A single licensing regime will be introduced for all persons carrying on a financial services business. This will replace licensing requirements currently applying to securities dealers, investment advisers, futures advisers and brokers, general and life insurance brokers, and foreign exchange dealers.

4.25 Financial services involve advising on, dealing in, or making a market in financial products; selling one's own financial product; operating a managed investment scheme; or providing a custodial or depository service.

4.26 A number of criteria will have to be satisfied in order to obtain a financial service provider's licence including:

- adequate financial resources for the performance of the proposed activities;
- competence, skills and experience to provide the relevant services; and
- adequate systems for training and supervision of representatives.

4.27 Conditions will be imposed on a financial service provider's licence to ensure that the licence criteria are satisfied on a continuing basis.

4.28 A licence will be required where services are provided to either wholesale or retail clients. Additional obligations will be placed on licensees who offer services to retail clients, such as a requirement to have arrangements for compensating clients for losses suffered.

4.29 Licences may cover all financial services in relation to all financial products or a subset of services and products.

4.30 Licensees may authorise natural persons or corporate representatives to act on their behalf.

4.31 Authorised representatives will be able to act for more than one licensee with the written consent of each licensee (cross endorsement).

Financial Service Provider Conduct and Disclosure

4.32 Minimum standards of conduct will apply to financial service providers when dealing with clients including:

- providing retail clients with a Financial Services Guide;
- 'know your client' requirements in relation to retail clients;
- disclosure of conflicts of interests to retail clients; and
- separation of funds held on a client's behalf, and reporting and accounting requirements.

4.33 A prohibition on unconscionable conduct in the provision of financial services will apply.

Financial Product Disclosure

4.34 The FSR Bill provides for disclosure throughout the life of a financial product from point of sale disclosure through the giving of a Product Disclosure Statement, confirmation of transactions, ongoing disclosure and periodic reporting requirements.

4.35 In relation to point of sale disclosure, a directed disclosure approach is taken with a list of topics under which information, if relevant to a particular financial product, must be included in the Product Disclosure Statement. This is supplemented by a requirement to include any other material information actually known to the product issuer.

4.36 The FSR Bill also provides for a number of other obligations in relation to the issue of financial products including handling money from applicants for financial products, alternative dispute resolution mechanisms for product issuers, requirements for advertising in relation to financial products and cooling-off periods for certain financial products.

Misconduct

4.37 A general prohibition on misleading and deceptive conduct will apply to dealings in financial products and provision of financial services. The provisions in the proposed Corporations Act and other applicable legislation will be harmonised to provide a single regime with respect to conduct in relation to financial products.

4.38 The penalty regime in relation to market misconduct will be amended to ensure that it efficiently promotes market integrity and investor confidence. Breaches of the market misconduct provisions will attract civil pecuniary penalties.

Transfer of Securities

4.39 The new arrangements will facilitate competition between clearing and settlement facilities.

4.40 The provisions of the proposed Corporations Act which facilitate the electronic transfer of the legal title to securities will not be limited to the SCH. Other suitably qualified clearing and settlement facilities which are prescribed will be entitled to transfer legal title to a range of financial products.

5

Abbreviations

5.1 The following abbreviations are used in this Explanatory Memorandum:

ACCC	Australian Competition and Consumer Commission
ADI	Authorised Deposit-taking Institution
APRA	Australian Prudential Regulation Authority
ASIC Act	*Australian Securities and Investments Commission Act 1989*
ASIC	Australian Securities & Investments Commission
ASX	Australian Stock Exchange
ATM	Automated Teller Machine
BRAG	Business Regulation Advisory Group
CASAC	Companies and Securities Advisory Committee
CLERP Act	*Corporate Law Economic Reform Program Act 1999*
CLERP	Corporate Law Economic Reform Program
Criminal Code	*Criminal Code* contained in the *Criminal Code Act 1995*
DPB	Declared Professional Body
ED	Enhanced Disclosure
FSG	Financial Services Guide
FSI	Financial System Inquiry
FSR Bill	Financial Services Reform Bill
IABA	*Insurance (Agents and Brokers) Act 1984*
Insurance Act	*Insurance Act 1973*
Insurance Contracts Act	*Insurance Contracts Act 1984*
Life Insurance Act	*Life Insurance Act 1995*
MINCO	Ministerial Council on Corporations
NGF	National Guarantee Fund
OTC	Over-the-Counter
PDS	Product Disclosure Statement
Proposed ASIC Act	Proposed *Australian Securities and Investments Commission Act 2001*
Proposed Corporations Act	Proposed *Corporations Act 2001*

PSB	Payments System Board
RBA	Reserve Bank of Australia
RSA Act	*Retirement Savings Account Act 1997*
RSA	Retirement savings account
SCH	Securities Clearing House
SEGC	Securities Exchanges Guarantee Corporation
SFE	Sydney Futures Exchange
SFSG	Supplementary Financial Services Guide
SIS Act	*Superannuation Industry (Supervision) Act 1993*
SoA	Statement of Advice
TPA	*Trade Practices Act 1974*
UCCC	Uniform Consumer Credit Code

6

Introduction and preliminary matters

Commencement of the Bill

6.1 The FSR Bill proposes amendments to the proposed Corporations Act which provides for a Commonwealth regulatory regime for corporations and the securities and futures industry based on a referral of powers from the States. Generally the FSR Bill will not commence at a minimum until immediately after the *Corporations Act 2001* commences (subclauses 2(3) and (4)). Provision is also made for the Bill to commence any time within 12 months after the commencement of the *Corporations Act 2001* (subclause 2(6)).

6.2 Part 1 of Schedule 3 which contains amendments to the proposed Corporations Act arising from changes made to the Corporations Law by the *Corporate Law Economic Reform Program Act 1999* (the CLERP Act) and the *Managed Investments Act 1998* will commence on Royal Assent or if the proposed Corporations Act has not commenced, immediately after it commences.

Scope of the FSR Bill

6.3 The FSR Bill is to replace a range of existing regulatory requirements including:

- Chapters 7 and 8 of the proposed Corporations Act;
- the *Insurance (Agents and Brokers) Act 1984*;
- aspects of the *Superannuation Industry (Supervision) Act 1993* and the *Retirement Savings Account Act 1997* and regulations and the *Insurance Act 1973*;
- aspects of the Banking (Foreign Exchange) Regulations.

6.4 Consequential amendments will also be necessary to other legislation, including the proposed Corporations and ASIC Acts and the Insurance Contracts Act, to accommodate changes being made by the FSR Bill.

6.5 Part 1 of Schedule 1 contains the proposed main amendments to the proposed Corporations Act for the establishment of a new regulatory regime for the financial services industry. The Part repeals Chapters 7 and 8 of the proposed Corporations Act dealing with the regulation of the securities and futures industry and inserts a new Chapter 7. Part 2 of Schedule 1 contains the proposed consequential amendments to the proposed Corporations and ASIC Acts necessary to accommodate the FSR Bill.

6.6 Further legislation will be required to make the consequential amendments to other legislation necessary as a result of the FSR Bill. These amendments will be in place prior to the commencement of the FSR Bill.

Key definitions

General definitions

6.7 Proposed Division 2 of Part 7.1 contains the key definitions applicable to Chapter 7 of the proposed Corporations Act. They will replace some of the existing definitions in Part 1.2 of the proposed Corporations Act and have been drafted so that they are capable of application to the full range of financial products that are to come within the Chapter. For example, the concept of 'able to be traded' will replace the term 'admitted to quotation' in relation to Chapter 7 to reflect the fact that the provisions will apply to all financial markets and not just those in relation to securities. Similarly, the concepts of 'acquire' and 'dispose' have been defined broadly to capture the wide range of products that are subject to the Chapter.

6.8 Part 2 of Schedule 1 contains further proposed amendments as a result of the FSR Bill to the definitions contained in Part 1.2 of the proposed Corporations Act. It also contains consequential amendments to other provisions in the proposed Corporations and ASIC Acts as a result of the changes being made by the FSR Bill. For example, a definition of 'futures contract' will no longer be required and will be replaced by the definition of 'derivative'.

6.9 For the most part definitions that are particularly relevant to certain parts of the Bill are considered in relation to those parts. Definitions that are relevant for the whole of the Bill are discussed below.

Retail/wholesale distinction

6.10 The Bill draws a distinction between retail clients and wholesale clients. Additional protections are afforded to retail clients in the form of:

- the Financial Services Guide;
- the Statement of Advice;
- the Product Disclosure Statement; and
- compensation and complaint handling arrangements.

Preliminary

6.11 Proposed subsection 761G(1) emphasises the underlying assumption of proposed section 761G, that financial products or financial services are provided to a person as a retail client except where the provision clearly states otherwise. Such a person is then also taken to acquire and dispose of the financial product or service as a retail client (proposed subsections 761G(2), (3)). That a person who does not acquire a financial product or service as a retail client is a wholesale client is put beyond doubt by proposed subsection 761G(4).

General insurance products

6.12 The definition in proposed section 761G distinguishes between:

- general insurance products;
- superannuation interests; and
- other kinds of financial products.

6.13 Proposed subsection 761G(5) applies to make either an individual or a small business (as defined in proposed subsection 761G(11)) a retail client, where they purchase one of the listed general insurance products. However, in the case of a small business, the product must be purchased for use in connection with that business.

6.14 The listed general insurance products are as follows:

- Motor vehicle insurance;
- Home building insurance;
- Home contents insurance;
- Sickness and accident insurance;
- Consumer credit insurance;
- Travel insurance;
- Personal and domestic property insurance; and
- such other general insurance as is prescribed by the regulations.

6.15 These types of insurance will be defined in the regulations. The first six listed types of insurance replicate those defined to mean standard cover in the Insurance Contracts Act and Regulations. These are essentially policies for personal, domestic and household protection, or 'consumer' policies. Personal and domestic property insurance is currently covered by insurance complaints handling mechanisms and, as a 'consumer' type of insurance, has also been included.

6.16 A person will therefore be a wholesale client where:

- the person acquires any type of general insurance policy not included in the list; or
- the person acquires a product in the list but is not an individual; or
- the person acquires a product in the list but is not acquiring the product for use in connection with a small business.

Superannuation and RSA products

6.17 Proposed subsection 761G(6) provides that where a person acquires a superannuation product or a retirement savings account (RSA) product, or a financial service related to one of these, the person acquires the product as a retail client. This test is not restricted to individuals and small businesses, but applies to all persons, regardless of their circumstances. This subsection was included due to the difficulty in drawing any meaningful distinction based on product value

between retail and wholesale clients in relation to superannuation and RSAs, given the large amounts frequently involved in superannuation payouts, for example.

Other kinds of financial product

6.18 Proposed subsection 761G(6) provides that a financial product (other than general insurance, superannuation and RSAs), or a financial service related to such a financial product, is provided to a person as a retail client except in four instances:

- where the price of the financial product, or of the product in relation to which the financial service is provided, exceeds the prescribed amount;
- where the business acquiring the product or service is above a certain size (that is, not a small business);
- where an individual provides evidence of a nominated level of personal wealth; or
- where the person is a 'professional investor'.

Product value test

6.19 The test in proposed paragraph 761G(7)(a) is based on the assumption that persons who can afford to acquire financial products or services with a value above the prescribed amount do not require protection as retail clients, as they may be presumed to have either adequate knowledge of the product or service, or the means to acquire appropriate advice.

6.20 The prescribed amount will be set by regulation. It is proposed to set the prescribed amount initially at $500,000 consistently with the 'sophisticated investor' test in paragraphs 708(8)(a) and (b) of the existing Corporations Law. However, regulations made under proposed subsection 761G(8) will also allow the amount to be varied in particular circumstances, if necessary.

Business test

6.21 The exception in proposed paragraph 761G(7)(b) results in 'big business' being treated as wholesale clients in relation to a financial product or service provided for use in connection with that business. There is no definition of 'big business' in the FSR Bill, instead it is defined negatively by reference to the definition of 'small business' in proposed subsection 761G(11).

6.22 Therefore, small businesses receive protection as retail clients under the regime, provided the financial product or financial service is acquired for use in connection with that business. A 'small business' is defined in proposed subsection 761G(11) as one that employs fewer than:

- if it is a manufacturing business — 100 people; or
- otherwise - 20 people.

Individual wealth test

6.23 This exception is also based on the concept of 'sophisticated investor' in paragraph 708(8)(d) of the existing Corporations Law. Proposed paragraph 761G(6)(c) enables a person to provide evidence that they have:

- net assets of at least $2.5 million; or

- gross income for each of the last two financial years of at least $250,000.

6.24 If a person produces a certificate to this effect, they will not be regarded as retail. Wealthy individuals may therefore choose to decline the retail protections, presumably on the basis that they either have considerable experience in making investments or have the means to seek appropriate advice.

Professional investor test

6.25 A professional investor test, based on the current test in subsection 708(11) of the existing Corporations Law has been introduced into the Bill in proposed paragraph 761G(7)(d). The definition of 'professional investor' will be inserted into section 9 of the proposed Corporations Act (for the purposes of subsection 708(11) as well) and covers persons who are:

- financial services licensees;
- bodies regulated by the Australian Prudential Regulation Authority (APRA);
- bodies registered under the *Financial Corporations Act 1974*;
- trustees of superannuation funds, approved deposit funds, pooled superannuation trusts and public sector superannuation schemes within the meaning of the SIS Act where the fund, trust or scheme has net assets of at least $10 million;
- control at least $10 million (including any amount held by an associate or under a trust that the person manages);
- listed entities or related bodies corporate of listed entities;
- exempt public authorities;
- investment companies as defined by Corporations Regulation 7.3.12(3); and
- foreign equivalents of the above.

6.26 The professional investor test was included in response to considerable concern by industry that retail protections would otherwise apply to financial and investment entities that fell within the definition of 'small business'.

Product value test — regulation making power

6.27 Proposed subsection 761G(8) allows the making of regulations to vary the application of the product value test in proposed paragraph 761G(7)(a), including varying the prescribed amount in relation to particular financial products. As superannuation interests are now dealt with separately in proposed subsection 761G(6), a particular application for this power is not currently envisaged. However, the existence of the power will ensure maximum flexibility in the application of the product value test.

Packages of financial products

6.28 Proposed subsection 761G(9) makes it clear that where a person acquires a package including both general insurance products and other kinds of financial products, these products must be separately assessed against the relevant subsections to determine whether a person must be treated as retail in respect of that element of the package.

Presumption of retail client

6.29 Proposed subsection 761G(10) reasserts the rationale underpinning the provision, that persons must be treated as retail clients unless it is clearly stated otherwise. This presumption applies only to financial products covered by the test in proposed subsection 761G(7), as the tests in proposed subsections (5) and (6) do not require such a presumption.

Small business definition

6.30 The definition of small business included at proposed subsection 761G(11) is discussed above in relation to the business test in proposed paragraph 761G(c).

Definition of financial product

6.31 Division 3 of Part 7.1 establishes the scope of the proposed new Chapter 7 in terms of the financial products to which it applies. As a general rule, all parts of the Chapter will apply to the full range of financial products as defined in this Division. That is, a person performing a particular function in relation to any of those products, such as operating a financial market or providing financial advice, will have to comply with the relevant parts of the Chapter.

6.32 However, some specific elements of the regime will apply on their face to a more limited range of financial products. For example, proposed Part 7.9 dealing with financial product disclosure (see Part 14 of this Explanatory Memorandum) will not apply to a security (as defined in proposed section 761A). There is also the facility within a number of elements of the regime to narrow the scope of products to which particular provisions are to apply, either by regulation or through an ASIC exemption and modification power. For example, Part 7.9 has both a regulation-making power and an ASIC exemption and modification power, which would enable the application of those provisions to particular financial products to be narrowed.

Basic deposit products

6.33 Special rules also apply in a number of areas of the FSR Bill to reduce the intensity of regulation in relation to 'basic deposit products' and related non-cash payment facilities on the basis that such products are capital guaranteed and well understood by consumers:

- employees of representatives authorised to provide services in relation to such products need not be authorised (proposed paragraph 911B(1)(c));
- a Financial Services Guide need not be given for a dealing in such a product, but an oral statement must be given (proposed subsection 941C(6));
- a Statement of Advice is not required, but certain information must be given (proposed subsection 946B(5)); and
- a Product Disclosure Statement may be given after the product is issued (proposed paragraph 1012G(1)(b)).

6.34 These rules have been relaxed on the basis that a customer can withdraw from a basic deposit product at any time without any loss of capital, other than transaction fees. Proposed section 761A defines a basic deposit product as a deposit product with a term of two years or less, allowing for the immediate withdrawal of funds without penalty other than the reduction of the interest rate, and with no entry and exit fees or ongoing management charges.

6.35 There is also provision for these special rules to be extended to other financial products by regulation.

Approach to defining financial product

6.36 The Bill takes a three-part approach to the definition of financial product which is outlined in proposed section 762A:

- a broad general definition of financial product which focuses on the key functions performed by financial products;

- this general definition is then clarified or added to by a list of specific inclusions and a regulation-making power to include further products. The list of inclusions is not a catch all list, but rather provides examples of products that fall within the general definition. The list is also drafted in such a way that it will bring products within the regime whether they fall within the general definition or not;

- the scope of both the general definition and the specific inclusions is then narrowed by a list of specific exclusions, a regulation-making power to exclude products and an ASIC exemption power;

6.37 This approach is intended to provide significant flexibility in defining the financial products that are to come within the regime and will be able to cater for emerging products without the need to amend the legislation.

6.38 Where a facility includes a number of components, only one of which is a financial product, the Chapter will only apply to the facility to the extent to which it consists of a financial product (proposed section 762C). For example, some banking products may involve dual credit and debit facilities. The Bill will only apply to the debit aspects of the facility and not the credit aspects.

General definition

6.39 The general definition in proposed Subdivision B of Division 3 focuses on three key functions that financial products provide:

- making a financial investment;

- managing a financial risk; and

- making non-cash payments (see proposed subsection 763A(1)).

'Facility' and 'arrangement'

6.40 What amounts to a financial product that enables a person to do one of the things specified in proposed subsection 763A(1) is defined broadly as a facility through which, or through the acquisition of which, the person does those things. A 'facility' is taken to include intangible property or an arrangement or term of an arrangement or both (proposed section 762C). For example, a share would be intangible property through the acquisition of which a person makes a financial investment.

6.41 'Arrangement' is also defined broadly, along the lines of the definition of 'Chapter 8 agreement' in existing section 9 of the Corporations Law to include formal and informal arrangements, whether oral or in writing and whether enforceable or not (proposed section 761A).

6.42 Two or more arrangements are also taken to constitute a single arrangement if this is what the parties intended (proposed section 761B). This is intended to pick up certain transactions which, if viewed separately, might not be regarded as a financial product, but if viewed together would be. This could be particularly relevant in relation to certain derivative transactions. For example, parties could enter into a deliverable commodity agreement and then a further agreement under which the party receiving the goods agrees to sell a similar quantity of goods back at market price. Neither agreement, of itself, would fall within the definition of derivative (see discussion below), but combined they would.

6.43 This provision only applies where an arrangement by itself would not amount to a financial product and does not apply to combine arrangements that would otherwise be financial products into a single arrangement. In that case, each arrangement is to be regarded separately as a financial product in its own right.

Particular person's purpose for acquisition irrelevant

6.44 A facility will be regarded as one for making a financial investment, managing a financial risk or making a non-cash payment even if this is not the purpose for which it is acquired, if it is the purpose for which a product of that kind is commonly acquired (see proposed subsection 763A(2)). For example, a particular person may enter into a derivatives transaction with a speculative purpose in mind. Notwithstanding this, the transaction will be regarded as one for managing a financial risk since persons commonly acquire such products to manage financial risks.

Secondary sale of financial products

6.45 Proposed subsection 763A(3) deals with the secondary sale of financial products and provides that a facility that was originally a financial product retains that character when it is on-sold notwithstanding that the person who is acquiring the product is not making a financial investment or managing a financial risk. This is intended to ensure, for example, that products such as securities, which on initial issue come within the concept of make a financial investment, retain that character when they are on-sold even though they would no longer come within that concept. The provision would apply similarly to a warrant, that on initial issue was a facility for managing a financial risk, but would not otherwise be on secondary sale.

Incidental products

6.46 Proposed section 763E is intended to ensure that the definition of 'financial product' does not pick up a range of consumer transactions that have an element, but not the primary purpose, of for example managing a financial risk. For example, the definition of 'managing a financial risk' could potentially cover warranty periods or guarantees in contracts for the sale of goods, or card registration services with the incidental benefit that the consumer will not be liable of any unauthorised use of a credit card between the time the service is notified of the loss and the time the service notifies the issuing bank. Similarly, a security bond arrangement by a telecommunications provider, which provided for the payment of interest, could be a facility for the making of a financial investment. Under proposed section 763E where the financial product purpose (making a financial investment, managing a financial risk, or making a non-cash payment) is incidental to the main purpose of a facility, it is not to be regarded as a financial product.

6.47 Proposed section 763E only applies to the general definition of 'financial product'. Thus to the extent that a product comes within the list of specific inclusions in proposed section 764A, it will come within the regime whether or not it is incidental to the main purpose of a facility. This means that products such as insurance associated with taking out a home loan or consumer credit insurance would be regulated under the regime, as would superannuation associated with a contract of employment.

Making a financial investment

6.48 The concept of 'making a financial investment' in proposed section 763B is broadly based on the concept of managed investment scheme in the existing Corporations Law. It has 3 key elements:

- the investor contributing money or money's worth;
- the generation or intended generation of a financial return or benefit. This takes account of the possibility of an investment giving rise to a loss. While the intention should be to generate a financial benefit, this may not always be the outcome; and
- the investor having no day-to-day control over the use of the money to generate the return.

6.49 The notes to the proposed provision contain examples of things that would and would not be regarded as making a financial investment.

6.50 By focussing on the actual, as well as the intended, use of the money the definition is intended to cover deposit accounts, which for many consumers are used for transactional purposes, although they also generate some return.

6.51 A provision in an arrangement for investment choice would not take a product outside the concept of making a financial investment. This would not be sufficient to amount to day-to-day control on the part of an investor.

6.52 While the definition is broadly based on the definition of managed investment scheme, the two terms are not intended to cover precisely the same field. Nothing in the definition of managed investment or making a financial investment is intended to limit the interpretation of the other. Both should be interpreted independently.

Managing a financial risk

6.53 Proposed section 763C is intended to bring within the regime as facilities for managing financial risk, products such as insurance contracts and derivatives. Concerns that the definition of 'managing a financial risk' might encompass such things as warranties and guarantees associated, for example, with the sale of goods that are only incidentally intended to manage a financial risk are addressed by proposed section 763E.

Making a non-cash payment

6.54 Proposed section 763D brings within the regime facilities enabling a person to make non-cash payments. It would cover, for example, direct debit facilities, cheques, purchased payment facilities such as certain smart cards and electronic cash arrangements.

Money changing transactions

6.55 Pure money changing foreign exchange transactions are taken outside the definition of a non-cash payment facility by the exclusion of payments involving the physical delivery of foreign currency in the form of notes and/or coins. They are also specifically excluded from the whole definition of 'financial product' by proposed paragraph 765A(1)(m).

Credit cards

6.56 By virtue of the exclusion of credit facilities from the regime as a whole (proposed paragraph 765A(1)(h)), it would not cover such products as credit cards which facilitate the making of

non-cash payments. Such cards, to the extent that they are used for domestic, personal or household use, are currently regulated under the Uniform Consumer Credit Code (UCCC). The will also be subject to the general consumer protection provisions in Division 2 of Part 2 of the ASIC Act.

Ultimate settlement systems

6.57 Similarly, through the list of specific exclusions, it is made clear that certain payments systems and other arrangements for the making of payments through such systems (such as the arrangements established by the Australian Payments and Clearing Association Limited), and settlement systems as between providers of non-cash payment systems are not brought within the definition of a non-cash payment facility (proposed paragraphs 765A(1)(i), (j) and (k)).

Single merchant payment facilities

6.58 Facilities that only facilitate the payment to a single person, such as store cards (to the extent that they are not credit and already outside the regime) and phone cards, are taken outside the regime, as it is considered that the consumer risk can be dealt with adequately under the general consumer protection provisions in Division 2 of Part 2 of the ASIC Act. The definition of 'financial product' in those provisions will be broader than the definition for the purposes of Chapter 7 to ensure that they cover such products. For similar reasons, limited purpose or person payment facilities may also be excluded by regulation (see proposed subsection 763D(2)). This is similar to the approach taken in section 9 of the *Payment Systems (Regulation) Act 1999* in relation to 'purchased payment facilities'.

Issuer of a non-cash payment facility

6.59 Who is the issuer of a particular financial product, including a non-cash payment facility, is dealt with in proposed section 761E. In particular, proposed subsection 761E(4) makes it clear that the issuer of the product is the person who is responsible to the client or for the obligations owed under the terms of the product. In relation to non-cash payments such as direct debit facilities, the issuer of the facility (who is subject to certain obligations under proposed Chapter 7, including financial service provider licensing and product disclosure) is the financial institution with which the account to be debited is held, rather than the person to whom payments can be made using the facility. Similarly, in relation to Automated Teller Machines (ATMs) it would be the financial institution with which the account being credited or debited through the use of the machine that would be the provider of the facility, not the supplier of the ATM.

6.60 Proposed paragraph 765A(1)(x) also excludes equipment or infrastructure by which something else that is a financial product is provided. This is intended to exclude the ATM itself or, for example, the services of telecommunications companies through which certain bill payment facilities operate. It is not intended to exclude the provision of financial services, such as custodial and depository services, in relation to financial products.

Specific inclusions

6.61 As noted above, the list of inclusions serves two purposes:

- to provide guidance on the content of the general definition;
- to include products which it is considered should be regulated under the regime notwithstanding that they do not fall within the general definition.

6.62 That is, it is not intended to be a comprehensive list and it may expand upon the general definition.

Security

6.63 A new definition of 'security' is provided for the purposes of Chapter 7 (see definition of 'security' in proposed section 761A). It is based on the new definition inserted by the CLERP Act in subsection 92(3) of the Corporations Law. However, it excludes interests in registered managed investment schemes. This approach has been taken in light of the fact that shares and debentures will be subject to a different disclosure regime under Chapter 6D than will interests in registered managed investment schemes, which will be subject to the disclosure regime outlined in Chapter 7.9 (see discussion in Part 14 of this Explanatory Memorandum).

6.64 The other significant difference between the definition of 'security' under proposed section 761A and the existing definitions in section 92 is that it will no longer include options over securities, other than options over unissued securities. The effect of this is that products such as many warrants will no longer fall within the definition of 'security', but instead will fall within the definition of 'derivative' (see discussion below). This means that most warrants and other options over securities will be subject to the Part 7.9 disclosure regime, rather than the disclosure regime in Chapter 6D. Regulations under the disclosure provisions will be used to ensure that all warrants, including those that will remain within the definition of 'security', will be subject to the Part 7.9 disclosure regime.

6.65 The definition of 'security' will also replace the definition in subsection 92(3) for the purposes of Chapter 6D. The subsection 92(3) definition will continue to apply for the purposes of Chapters 6 to 6CA inclusive. This has been done on the basis that it is appropriate that the takeovers provisions continue to apply to managed investments and to options over securities.

6.66 Where necessary, references to securities in the remainder of Chapter 7, which should appropriately extend to managed investments have been extended to securities and managed investments.

6.67 Although the defined term 'security' is in the singular, it is intended that references to the plural 'securities' in Chapter 7 are also to be taken to refer to this definition, rather than the definition of 'securities' in section 92.

6.68 The definition of security takes precedence over the definition of 'derivative'. This is achieved by paragraph 761D(3)(d) of the definition of 'derivative'. This means that a hybrid security and derivative product will be regarded as a security.

Managed investment product

6.69 Only interests in registered managed investment schemes will be brought within the regime (see proposed paragraph 764A(1)(b)). The regime will not apply to interests in registered managed investment schemes which are constituted by a right to participate in a retirement village scheme (see definition of excluded security in section 9 of the proposed Corporations Act). Proposed paragraph 764A(1)(b) also brings within the regime legal or equitable rights or interests and options to acquire interests in registered schemes.

6.70 Interests in managed investment schemes operated outside this jurisdiction that would have to be registered if they were operated in this jurisdiction will also be brought within the regime (proposed paragraph 764A(l)). Similarly, interests in managed investment schemes operated outside this jurisdiction that would not have to be registered if they were operated in this

jurisdiction are specifically excluded from the regime (proposed paragraph 765A(s)). This also includes legal or equitable rights or interests and options to acquire interests in such schemes.

6.71 While as a general rule options to acquire interests in registered schemes are of themselves interests in a scheme by virtue of the definition of 'interest' in section 9 of the proposed Corporations Act, proposed subparagraph 764A(1)(b)(iii) has been included to cover the rare circumstance where the option is created by a person having a right to be issued interests who is not the responsible entity or their associate.

Derivatives

6.72 The definition of 'derivative' in proposed section 761D has been formulated to replace the existing definition of 'futures contract' in section 72 of the proposed Corporations Act. As recommended by CASAC in its report entitled *'Regulation of On-exchange and OTC Derivatives Markets'* the definition focuses on the functions or commercial nature of derivatives rather than trying to identify each product that will be regarded as a derivative. The definition proposed by CASAC in its report has been used in developing the definition in proposed section 761D.

6.73 Features of the definition of 'derivative' to note are:

- under the arrangement a person must or may be required to provide consideration at some future time. This ensures that options that otherwise fall within the definition are captured (proposed paragraph 761D(1)(a));

- the consideration is of a particular kind or kinds. This would cover those contracts that provide for cash settlement or physical delivery (proposed paragraph 761D(1)(a));

- contracts, such as spot foreign exchange transactions, which could vary in value as a result of movements in the exchange rate during the settlement period, will be excluded by regulation under proposed paragraph 761D(1)(b);

- the definition covers all arrangements where the amount of the consideration or the value of the arrangement varies by reference to something else (of any nature whatsoever and whether deliverable or not), including but not limited to a commodity (proposed paragraph 761D(1)(c));

- it encompasses arrangements under which both the amount of the consideration or the value of the arrangement varies by reference to something else. This ensures that the definition covers deliverable options and futures contacts under which the consideration remains the same but the value of the arrangement varies by reference to something else (proposed paragraph 761D(1)(c));

- all consideration, including initial or periodic consideration, the amount of which was fixed at the time the arrangement was entered into, is taken into account, ensuring that options under which the obligation to pay the other party a variable amount only arises on the occurrence of a future contingent event.

- proposed paragraph 761D(3)(a) excludes from the regime a range of transactions involving the future delivery of something, including such things as contracts for the sale of land with a three month settlement period, while bringing within the regime those forward rate agreements that should be regarded as derivatives, because they are being used for hedging or speculative purposes. This is a difficult dividing line to draw as much depends on the intentions of the particular parties concerned. The existing Corporations Law seeks to deal with this issue by the concept of the likelihood of the agreement being settled other than by delivery (see definition of 'eligible commodity agreement' in section 9 of the Corporations Law). However, CASAC explicitly rejected this test on the basis that the 'unlikely' requirement was not clear and some

futures contracts such as deliverable share futures may not be likely to be closed out. Proposed section 761D seeks to address this issue by:

- applying the relevant exclusion to tangible property only. It would not therefore apply to a deliverable share or bank bill future, as the underlying property is intangible (proposed subparagraph 761D(3)(a)(i));

- rather than focussing on the mandatory delivery aspect, it looks to whether the arrangement can settled by cash or by set-off between the parties. If the arrangement relates to tangible property and can not be cash settled, it will fall outside the definition of derivative (proposed subparagraph 761D(3)(a)(ii));

- contracts which provide for some top-up of cash in the event that tangible property does not meet the standard for delivery would none the less be excluded from the definition as a result of the reference to wholly settled by cash in proposed subparagraph 761D(3)(a)(ii);

- looking to the wider context in which the arrangement is made and recognising that while a contract on its face appears to require delivery of tangible property, market practice or the rules of a market or clearing and settlement facility mean that delivery is not mandatory, but that the contact can be closed out by entering into an offsetting transaction (proposed subparagraph 761D(3)(a)(iii)).

- The definition covers all options other than:

  - options over unissued shares, which fall within the definition of 'security' (proposed paragraph 761D(3)(c));

  - options over tangible property which do not allow for cash settlement. Such options would fall within the exclusion in proposed paragraph 761D(3)(a); and

  - any other options prescribed by regulations (proposed paragraph 761D(3)(d) allows regulations to exclude things from the definition of 'derivative').

- Proposed subsection 761D(4) takes out of the definition of 'derivative' arrangements that only vary by reference to a general inflation index. This is intended to take outside the definition arrangements that would otherwise be derivatives merely because they have an inflation clause in them.

Insurance

6.74 Proposed section 761A contains three definitions that are relevant to the products distributed by the insurance industry:

- general insurance product – this is defined in proposed paragraph 764A(1)(d) as a contract of insurance that is not a 'life policy' or a 'sinking fund policy' within the meaning of the *Life Insurance Act 1995* (Life Insurance Act);

- life risk insurance product – this is defined in proposed paragraph 764A(1)(e) as a 'life policy' or 'sinking fund policy' within the meaning of the Life Insurance Act that is a contract of insurance. Following amendments made to the Life Insurance Act by the *Financial Sector Reform (Amendments and Transitional Provisions) Act (No. 1) 1999*, this would include such products issued by a friendly society;

- investment life insurance product – this is defined in proposed paragraph 764A(1)(f) as a 'life policy' or a 'sinking fund policy' within the meaning of the Life Insurance Act that is not a contract of insurance. This would pick up paragraphs (f) and (g) of the definition of 'life policy' in section 9 of the Life Insurance Act. It would also include such products issued by a friendly society.

6.75 Each of these categories of insurance is taken not to include:

- benefits provided by an association of employees that is an organisation for the purposes of the *Workplace Relations Act 1996*;

- superannuation benefits, pensions and payments to employees on retirement, disability or death provided by an employer or by employees as outlined in subsection 11(3) of the Life Insurance Act;

- funeral benefits;

- policies issued by an employer to an employee.

Superannuation products

6.76 The regime will apply to 'superannuation interests' within the meaning of the SIS Act (proposed paragraph 764A(1)(g)). Under that Act a superannuation interest means a beneficial interest in a superannuation entity and a 'superannuation entity' means:

- a regulated superannuation fund;

- an approved deposit fund; or

- a pooled superannuation trust (see section 10 of the SIS Act).

6.77 There are regulation-making powers in a number of parts of the regime which will enable the class of superannuation interest to which the particular provisions are to apply to be modified (see, for example, proposed section 1020G in relation to product disclosure).

6.78 The definition of financial product will include 'self managed superannuation funds' as defined by section 17A of the SIS Act. However, such funds will be excluded from the licensing and conduct and disclosure obligations in Parts 7.6-7.8 of the FSR Bill by regulation. They will be subject to the product disclosure provisions in Part 7.9. The disclosure requirements for such funds will be detailed in the regulations as they currently are under the SIS Act. The Australian Taxation Office will continue to have administrative responsibility for self managed funds. This will be provided for in consequential amendments in subsequent legislation.

Foreign currency transactions

6.79 Proposed paragraph 764A(1)(k) includes within the definition of 'financial product' foreign currency transactions where currency is not immediately exchanged, in recognition of the risk associated with the settlement period that typically characterises such transactions. It will also enable Australia to implement any recommendations that might flow out of the Financial Stability Forum (such as requiring disclosure of foreign exchange positions or the possible introduction of a code of practice for market conduct in this area). Where such transactions would fall within the definition of 'derivative', they will be regarded as derivatives.

6.80 Thus only pure money changing transactions will not be regarded as financial products for the purposes of proposed Chapter 7 on the basis that the only issues relevant to the consumer are, what is the exchange rate and how much is being charged for the service of exchanging it. The consumer knows up-front what they are receiving and there are no lags between entering the contract and receiving the benefits of the contract. These transactions will, however, be subject to the general consumer protection provisions contained in Division 2 of Part 2 of the proposed ASIC Act.

Other specific inclusions

6.81 Also specifically included are the following products:

- retirement savings accounts (RSAs);
- deposit-taking facilities made available by an authorised deposit-taking institution (ADI). However, consistent with the coverage of the Banking Act, a facility that is used for state banking is specifically excluded (see proposed paragraph 765A(1)(s));
- a debenture, stock or bond issued or proposed to be issued by a government. It should be noted, however, that existing Chapter 7 of the Corporations Law does not bind the Crown in right of a State or Territory, of the Commonwealth or of Norfolk Island (see subsection 5A(4) of the proposed Corporations Act). It is intended that the effect of this provision in relation to debentures, stocks or bonds issued by a government will be continued under the new Chapter 7; and
- something declared by the regulations to be a financial product.

Specific exclusions

6.82 Proposed section 765A outlines the products that are specifically excluded from the regime. It applies whether the products fall within either the general definition or the list of specific inclusions. Additional products may be excluded by regulation or by ASIC (proposed paragraphs 765A(1)(y) and (z)).

Exclusion of credit

6.83 Credit facilities are not covered under the definition of 'financial product'. To the extent that such facilities are consumer credit, they will be regulated under the State-based UCCC regime. All credit will also be subject to the general consumer protection provisions in Division 2 of Part 2 of the proposed ASIC Act (see discussion above).

6.84 Although credit is not specifically included in the regime either by the general definition or the list of specific inclusions, it is possible that certain credit arrangements could have fallen within elements of the general definition. For example, fixed rate loans could have been regarded as a facility for managing a financial risk and credit cards would have been facilities for the making of non-cash payments. For this reason credit facilities are specifically excluded from the definition of financial product (proposed subparagraph 765A(1)(h)(i)). The regulations will define what is a credit facility for the purposes of the provisions. Generally any facility that would be regarded as credit (and not just consumer credit) for the purposes of the UCCC will be prescribed by the regulations.

6.85 In addition to excluding credit facilities, the Bill also excludes facilities for the making of non-cash payments if payments made using the facility are debited to a credit facility prescribed by the regulations (proposed subparagraph 765A(1)(h)(ii)). This is intended to exclude, for example, payments made through a bill payment facility that are effected by using a credit card. This is in

recognition of the fact that the credit card facility itself would not be subject to the regime, so any associated non-cash payment facility should also be excluded. However, any payments made through such a facility that are debited, for example, from a deposit account, would be covered by the regime as such accounts come within the regime.

Wrap accounts

6.86 Wrap accounts, which are arrangements under which a number of products are provided together (with or without choices) to a person along with administrative services in relation to those products, are not of themselves regarded as a financial product. Rather, each product offered under the wrap account is regarded as a separate financial product.

6.87 It is intended that services offered by the wrap account provider come within the definition of 'financial services business'. The outcome of this approach is that a wrap account provider will be required to be licensed and will have to provide a Financial Services Guide in relation to the services that it offers.

Definition of financial service

6.88 Proposed Division 4 of the Bill describes what amounts to the provision of a 'financial service'. This is a key definition in the Bill as a person who provides financial services is generally taken to carry on a 'financial services business', and therefore requires an Australian financial services licence in order to provide the relevant service(s).

When does a person provide a financial service?

6.89 Under proposed section 766A, a person provides a financial service if they:

- provide financial product advice;
- deal in a financial product;
- make a market for a financial product;
- operate a registered scheme;
- provide a custodial or depository service; or
- engage in any other conduct prescribed by the regulations for the purposes of this provision.

6.90 Proposed section 766A makes it clear that a person does not provide financial advice where the conduct is carried out in the course of work ordinarily done by clerks or cashiers.

6.91 Regulations may be made under proposed subsection 766A(2) to set out the circumstances in which persons are taken to provide, or not to provide, a financial service, including the situation where a person facilitates the provision of a financial service (for example, by publishing information).

Financial product advice

6.92 'Financial product advice' is defined in proposed section 766B to mean a recommendation, a statement of opinion, or a report of either of those things, which is intended to influence, or which

could reasonably be regarded as being intended to influence, a person in making a decision in relation to a particular financial product, a class of products or an interest in such products.

6.93 However, financial product advice does not include anything in an exempt document, which is defined in proposed subsection 766B(6) to mean a document prepared in accordance with Chapter 7 (other than a document prescribed by the regulations for the purposed of this subsection), or any other document prescribed by the regulations for the purposes of this subsection. This exception will therefore cover any advice given in a Financial Services Guide, a Statement of Advice and a Product Disclosure Statement.

6.94 A further exception under proposed subsection 766B(5) is advice given by a lawyer in their professional capacity on legal issues.

6.95 There are two types of financial product advice: personal advice and general advice. Different disclosure requirements apply depending on whether advice is personal or general (proposed Part 7.7 of the Bill).

6.96 'Personal advice' is defined in proposed subsection 766B(3) as financial product advice given to a person where the provider of advice has considered the objectives, financial situation and needs of the person, or where the person might reasonably expect that the provider has considered these matters.

6.97 'General advice' is financial product advice that is not personal advice, according to proposed subsection 766B(4).

Dealing in a financial product

6.98 Dealing in a financial product is defined in proposed section 766C as applying for or acquiring, issuing, underwriting (in relation to securities or managed investments), varying or disposing of a financial product, or arranging for a person to engage in this conduct.

6.99 A person is taken not to deal (and therefore not to be providing a financial service) where:

- the person deals in a product on their own behalf. The exception to this is where the person is an issuer of financial products and the dealing is in relation to one or more of those products (proposed subsection 766C(3)).

- the person is a government, local government authority, public authority, or instrumentality or agent of the Crown and issues debentures, stocks or bonds, or deals only in securities relating to that entity (proposed subsection 766C(4)).

- the person is a body corporate or unincorporated body and the relevant transactions relate only to securities of that entity. However, these bodies are caught where they carry on an investment business and, in the course of the business, invest funds after an offer to the public (proposed subsections 766C(4), (5)).

- the person is a sub-underwriter and the relevant transaction is an issue of shares relating only to the sub-underwriting (proposed subsection 766C(6)).

- the conduct is prescribed by the regulations as not amounting to dealing in a financial product.

Make a market for a financial product

6.100 A person makes a market for a financial product if they regularly state the prices at which they propose to acquire or dispose of financial products on their own behalf, and other persons have a reasonable expectation that they will be able to regularly effect transactions at the stated prices, and the actions of the person do not constitute operating a financial market because of the effect of subsection 767A(2)(a) (proposed section 766D).

Operate a registered scheme

6.101 Proposed subsection 766A(4) provides that a person is not operating a registered scheme merely because they are acting as agent or employee of another person, or taking steps to wind up the scheme.

Provide a custodial or depository service

6.102 Custodial and depository services have been included in the new regime to ensure that consumers of these services receive sufficient disclosure to make informed decisions about whether to use the services, and can be confident that service providers are competent, and have adequate compensation arrangements in place and provide access to dispute resolution procedure for retail clients. Custodial and depository services have also been included for market integrity reasons, to ensure that service providers have appropriate risk management procedures in place.

6.103 However, there are many circumstances in which client assets are entrusted to third parties where this level of regulation would not be justifiable, for example where a consumer's assets are held in a bank safe deposit box. Further, where a person merely holds the assets of a managed investment scheme this level of regulation is not justified since the person holding the assets is acting under the direction of the responsible entity of the scheme. The definition therefore only covers situations where a service provider both possesses or controls client assets and provides administrative functions in relation to those assets.

6.104 Under proposed section 766E, a person provides a custodial or depository service where, under an arrangement with a client, they have possession or control of the client's assets in connection with the person providing a financial product to the client and they:

- settle transactions relating to the assets;
- collect or distribute dividends or other pecuniary benefits derived from the assets;
- pay tax or other costs associated with the assets;
- exercise rights, for example voting rights, attached to or derived from the assets; or
- perform any other function necessary or incidental to the safeguarding or administration of the assets. It is anticipated that this would include record-keeping and reporting functions.

6.105 A person also provides a custodial or depository service where they agree or undertake to provide such a service, or arrange for a third party to provide such a service to a client (proposed subsection 766E(2)).

6.106 Under proposed subsection 766E(3), the following conduct does not amount to providing a custodial or depository service:

- the operation of a clearing and settlement facility;

- the operation of a registered managed investment scheme;
- the operation of a regulated superannuation fund, an approved deposit fund or a pooled superannuation trust;
- the provision of services to a related body corporate;
- any other conduct prescribed by the regulations.

Financial services business

6.107 'Financial services business' is defined in proposed section 761A as meaning a business of providing financial services. In working out whether someone carries on a financial services business, regard should be had to Division 3 of Part 1.2 of the proposed Corporations Act. For the purposes of proposed Chapter 7, paragraph 21(3)(e) in that Division will not apply.

6.108 The common law meaning of 'carrying on a business' encompassing elements of system, repetition and continuity suggests that one-off transactions relating to the provision of financial services and financial products are unlikely to be caught by this regime. So, for example, a one-off issue of securities would be unlikely to fall within the definition of 'carrying on a financial services business'.

General provisions relating to civil and criminal liability

General approach to offences in the Bill

6.109 A range of mechanisms will be available to ensure that provisions in the FSR Bill can be effectively and appropriately enforced. Depending of the nature of the provision, these may include one or more of: a prosecution for an offence; a civil penalty; injunctive action (particularly the wide powers available to ASIC under proposed section 1101B), as well as the ability of ASIC to impose conditions on, suspend or cancel a licence. These last powers relating to licences are particularly relevant to the proposed Chapter 7 as most of the offences apply to people who hold either financial services, market or clearing and settlement facility licences. In some circumstances, people may also be able to take civil action to recover loss or damage incurred as the result of another person's contravention of a provision.

6.110 In determining which provisions should be subject to criminal liability and the nature of these offences including the appropriate fault elements, application of strict liability and penalties, consideration has been given to other types of enforcement action that may be available.

How offences are created

6.111 Offences for contraventions of provisions in the Bill are created either through the operation of subsection 1311(1) or by provisions in a specific enforcement related Division at the end of a Part (this approach is taken in Parts 7.7, 7.8 and 7.9). To ensure that it is clear when a provision is subject to a criminal penalty, there are provisions at the beginning of these Parts (such as proposed section 940D) indicating that this approach has been taken. In addition, notes have been placed under all provisions where offences are created through subsection 1311(1).

6.112 Penalties for all offences will be contained in Schedule 3. In determining appropriate penalties, those for similar offences elsewhere in the existing Corporations Law were taken into account.

6.113 It is proposed that Chapter 7 will be included in the list of provisions in subsection 1311(1A) to which section 1311(1) does not apply unless there is a specific penalty listed in Schedule 3 (Schedule 1, Part 3, Item 29). The result of this will be that unlike the other Parts of the proposed Corporations Act, the only offences will be those created specifically by the provisions themselves or through the insertion of a penalty into Schedule 3.

6.114 The proposed Chapter 7 places an increased emphasis on regulations so as to maintain the flexibility necessary for the new regime. Therefore, it is proposed to increase the maximum penalty for an offence contained in regulations from $1000 to 50 penalty units. This will ensure that regulations which create obligations can also create offences with an appropriate penalty for their contravention.

Application of Criminal Code

6.115 The Criminal Code will apply on commencement to all 'offences based on' provisions in the proposed Chapter 7, that is, all offences created by the provision itself or created through the operation of subsection 1311(1) or section 1314 (continuing offences), (see proposed definition of 'offence based on' (Item 250 of Schedule 1, Part 2)). Therefore, in most instances the default fault elements specified in the Criminal Code of intention in relation to conduct and recklessness in relation to results or circumstances will be implied into offences.

Responsibility for conduct of other people

6.116 The proposed Chapter 7 contains a provision that sets out when a person is responsible for the conduct of other people (proposed section 769B), it has effect instead of Part 2.5 of the Criminal Code which provides a default rule dealing with corporate criminal responsibility.

6.117 This provision is based on section 762 of the existing Corporations Law. It applies in relation to proposed subsection 769B(10) prosecutions for offences, proceedings for civil penalty orders or civil actions under Part 9.4B, and proceedings under Chapter 9 where these are related to provisions of the proposed Chapter 7.

6.118 It provides for the situations where:

- conduct by a person is attributed to a body corporate (proposed subsection (1)), for example, the conduct of an employee of a company where that person is acting within their actual authority is taken to be conduct of that company;

- conduct by a person in relation to another person is attributed to a body corporate (proposed subsection (2)), for example, if a person gives money to an employee of a company that money is taken to have been given to the company itself;

- the state of mind of a body corporate is derived from the state of mind of persons associated with that body corporate (proposed subsection (3)), for example, if a director of a company acting within their actual authority knows something, then the company is also taken to know that thing.

6.119 Proposed subsections 769B(4), (5) and (6) similarly deal with the situations where a person (other than a body corporate) has employees or agents, and conduct done by or in relation to those people is taken to be done by or in relation to that natural person, and also deals with the circumstances when that person is taken to have a state of mind that an employee or agent of the person has.

6.120 Proposed subsection 769B (7) excludes Part 7.7 from these general rules where it concerns the provision of a financial service by an authorised representative of a financial services licensee. This is necessary as Part 7.7 contains special rules about the liability of authorised representatives and licensees for a failure by an authorised representative to comply with a provision of that Part. Similarly, subsection (8) excludes Division 2 of Part 7.9 from these general rules to the extent that it relates to the liability of one regulated person for the actions of another regulated person, as that Part contains specific provisions dealing with that situation.

ASIC Exemption and Modification Provisions

6.121 In the Bill there are a number of proposed provisions that give ASIC the power to make exemptions or modifications to proposed Chapter 7 (for example, proposed sections 951B and 1020F). These provisions contain a requirement that ASIC must notify a person in writing about a modification or make it available on the Internet before such a modification can result in the person having any additional criminal liability. Generally, exemptions are not subject to the same notice requirements, as contraventions of exemptions do not give rise to any additional criminal liability.

6.122 However, in proposed section 798D, dealing with exemptions for self-listing licensees, a contravention of an exemption is an offence, so that in that provision the notice requirement extends to both modifications and exemptions. In addition, as that provision relates to exemptions and modifications in relation to market licensees, it is appropriate that the notification has to be in writing to individual licensees. The scope of the provision means that this would not be an overly onerous requirement on ASIC.

6.123 These proposed provisions will ensure that people cannot potentially be subject to criminal liability for failing to comply with requirements about which they could not have been aware.

7

Licensing of financial markets

Preliminary

7.1 The objects of the Chapter are found in proposed section 760A and should be read in conjunction with ASIC's charter in section 1 of the ASIC Act.

7.2 The purpose of proposed Part 7.2 is to provide a more flexible regulatory framework than currently applies to securities and futures exchanges. Instead of the seven routes to authorisation for financial markets, there will be one.

7.3 While the provisions in proposed Part 7.2 differ from those found in current Parts 7.2 and 8.2 of the Corporations Law, there is no intention to increase the regulatory burden. Some of the new provisions reflect the more complete framework included in the draft provisions. An example is proposed sections 797B to 797G, which relate to suspension of a licence. Other provisions, which may appear to impose additional obligations, make explicit requirements which exchanges would currently be expected to fulfil. An example is the requirement, expected to be included in the regulations, for rules relating to the procedure in the event of a default.

Allocation of responsibilities

7.4 In brief, Part 7.2 will:

- allocate different responsibilities to the Minister, ASIC and market licensees respectively in pursuing the functions which they each have of monitoring and promoting market integrity and consumer protection;

- in particular, the market licensee has the primary responsibility for ensuring that the rules and procedures of the market and their enforcement by the operator are consistent with the objectives of fairness, orderliness and transparency, and is the front-line regulator of participants' conduct in relation to the market;

- ASIC has primary responsibility for ensuring that participants on a market comply with the Law and Regulations and exercises oversight of the market licensee to ensure that it complies with its ongoing obligations;

- the Minister, with the advice and assistance of ASIC, has primary responsibility for the licensing of markets, as well as such associated matters as the suspension and cancellation of the licence, and determining whether the market's operating rules are consistent with the operator's obligations.

Provisions to be repealed

7.5 Proposed Part 7.2 will replace the following Parts of the proposed Corporations Act:

- Part 7.2 (Securities Exchanges and Stock Markets);
- Part 8.2, Divisions 1 and 3 (futures exchanges, exempt futures markets and futures associations) and 4 (to the extent that it applies to these bodies).

Requirement to be licensed

Need for a licence

7.6 A person must not operate a financial market unless they have an Australian market licence to operate the market or the market is exempt (proposed section 791A).

7.7 The prohibition extends to holding out that the person has an Australian market licence, that the operation of a market is authorised by an Australian market licence, that a market is exempt or that a person is a participant in a licensed market when that is not the case (proposed subsection 791B).

7.8 Assisting in the operation of a financial market in contravention of proposed section 791A is covered by the *Criminal Code Act 1995* and is therefore not explicitly mentioned in these provisions.

7.9 Proposed sections 791A and 791B will replace sections 767 and 1123 of the Corporations Law.

7.10 Strict liability will be applied to proposed paragraph 791A(1)(b) which provides that a person does not need a licence to operate an exempt market. The application of strict liability in this situation means that for an offence of operating a market that is not exempt without a licence there is no burden on the prosecution to show that a defendant knew or was reckless as to whether the market was not exempt, a matter that it might otherwise be difficult to show that a defendant had considered. Strict liability has not been applied in relation to paragraph (a), as the prosecution would not have the same difficulty in showing that a person knew or was reckless as to the fact that they did not have a licence.

7.11 For an offence under proposed section 791A and some other offences related to proposed Part 7.2, there are higher pecuniary penalties (up to 500 penalty units) than for equivalent offences in other parts of the Bill. This reflects the nature and size of bodies that are likely to be operating financial markets.

What is a financial market?

Proposed section 767A - What is a financial market?

7.12 The phrase 'financial market' is defined in proposed section 767A in terms which are derived from the definition of 'stock market' in section 9 of the Corporations Law.

7.13 However, it includes several modifications:

- to clarify its operation, particularly to the 'OTC market' (see paragraph 767A(2)(a), which is discussed below);

- to omit information providers on the basis that the obligations imposed by Part 7.2 are not appropriate if only information is being provided;

  – information providers may, however, be subject to other aspects of the new regime — if, for example, interpretation of the information is provided, then the provider will be providing financial product advice and be required to be licensed as a financial service provider;

- to include a regulation-making power so that, if necessary, other conduct can be taken out of the definition of 'financial market'.

Meaning of 'facility'

7.14 The word ‘facility’ is not defined. However, it is clearly not the intention to regulate as the operator of a financial market a person whose involvement is limited to operating an electronic means of communication or is merely an Internet service provider.

What conduct is excluded?

7.15 In summary, the following conduct will not constitute operating a 'financial market':

- transactions involving direct negotiation, as described in proposed paragraph 767A(2)(a);

  – the intention is to exclude the making or accepting of offers or invitations to acquire or dispose of financial products in circumstances that involve direct negotiation between the parties who each accept the counterparty credit risk;

    : this is expected to exclude most transactions which are considered to form part of the informal ‘OTC market’;

  – the 'financial market' encompassed in the definition would involve multiple buyers and sellers using the facility - the situation described in proposed paragraph 767A(2)(a) would not fit this concept;

  – a regulation-making power is included in proposed paragraph 767A(2)(a) so that its ambit can be adjusted - for example, in relation to central counterparty markets;

- conducting treasury operations between related bodies corporate (proposed paragraph 767A(2)(b));

  – the term ‘treasury operations’ should have its usual business meaning and is expected to refer to the operations of one member of a corporate group in arranging dealings between members of the corporate group.

  – to the extent that the nominated member of the corporate group arranges dealings on behalf of another member of the group with an unrelated company or person, then it may be acting in the capacity of an agent for the second member of the group and this activity would not constitute operating a market.

- conducting an auction of forfeited shares (proposed paragraph 767A(2)(c)); and

- any other prescribed conduct (proposed paragraph 767A(2)(d)).

7.16 The exclusion of auctions of forfeited shares currently appears in section 773 of the Corporations Law. The other exclusions referred to above are not currently found in the Corporations Law, but it is considered inappropriate to regulate such conduct as a market.

Regulated activity

7.17 Activities of a licensee which are outside the scope of the conduct which the legislation regulates are the legitimate concern of the regulator to the extent that they are relevant to the core area of regulation (for example, where resources are diverted from the regulated conduct to the other businesses, or where the commercial imperative of those other businesses may conflict with the obligations imposed in relation to the regulated activity).

When is a market taken to be operated in this jurisdiction?

7.18 Proposed section 791A provides, among other things, that a person must not operate a financial market in this jurisdiction unless licensed to do so or the market is exempt.

7.19 The concept of 'operating in this jurisdiction' is affected by proposed section 791D which provides for an extension to the concept: the regime will apply to market operators which are registered (incorporated) in Australia and which operate a financial market either in Australia or elsewhere (proposed subsection 791D(1)). The purpose of this extension is to protect Australia's national interest and prevent its reputation as a global financial centre being compromised by unscrupulous operators of markets which may incorporate in Australia in order to operate elsewhere.

7.20 The inclusion of proposed subsection 791D(1) does not have any effect on the application of proposed sections 791A and 791B to natural persons.

7.21 The concept of 'operating in this jurisdiction' is not otherwise defined. However, it is expected that mere accessability by one or a few persons in Australia to an electronic market operated from an overseas jurisdiction will not constitute operation of the market in Australia.

The power to exempt

7.22 The Minister will be empowered to declare in writing:

- a particular financial market; or
- a particular type of financial market;

to be exempt from the requirement to be licensed (proposed subsection 791C(1)). The exemption may be subject to conditions.

7.23 In addition, after the exemption has been declared, the Minister will be empowered to impose conditions, or additional conditions, vary or revoke conditions and revoke the exemption (proposed subsection 791C(2)).

7.24 The provision requires notice and an opportunity to make submissions before the Minister may take such action in relation to an existing exemption (proposed subsection 791C(3)).

7.25 It is anticipated that conditions will be necessary to, for example, limit the exemption to the relevant 'market', as proposed when the exemption was granted.

7.26 This power is not a substitute for sections 771 and 1127 of the Corporations Law which currently empower the Minister to declare that a specified stock or futures market is exempt. The current powers have been used to provide a specific regulatory regime for markets which do not fit the criteria for approval as a stock or futures exchange. This has been done through exemptions granted on extensive conditions.

7.27 It is envisaged that the new exemption provision will be used in limited circumstances — for example, in relation to a facility for which there is no policy reason to regulate as a market.

How to apply for an Australian market licence

7.28 The first step in applying for an Australian market licence will be to lodge an application, which includes the prescribed information, addresses the need for compensation arrangements (if required) and is accompanied by the prescribed documents and fee, with ASIC (proposed subsection 795A(1)).

7.29 ASIC will then be required, within a reasonable time, to give the application to the Minister with its advice (proposed subsection 795A(2)).

When an Australian market licence may be granted

7.30 Before the Minister may grant a licence under proposed section 795B(1), he or she must be satisfied that:

- the applicant has made an application, as required (proposed paragraph 795B(1)(a));
- the applicant can meet the obligations which will apply (which are described below) (proposed paragraph 795B(1)(b));
- the applicant has adequate rules and procedures (see proposed section 793A which is described below) to ensure, as far as is reasonably practicable, that the market will operate in a way that promotes the objectives of fairness, orderliness and transparency (and, in particular, to the extent that those objectives are consistent with one another) (proposed paragraph 795B(1)(c) and paragraph 792A(a));
- the applicant has adequate arrangements for supervising the market including arrangements for handling conflicts between its own commercial interests and its role as a market supervisor, monitoring the conduct of participants in relation to the market and enforcing compliance with the market's operating rules (proposed paragraph 795B(1)(d));
- if the Minister considers it to be appropriate in the circumstances, the applicant has adequate clearing and settlement facility arrangements for transactions effected through the market (proposed section 790A (definition of 'clearing and settlement arrangements') and paragraph 795B(1)(e));
- the need for compensation arrangements has been addressed and, if necessary, approved (see Part 7.5) (proposed paragraph 795B(1)(f));
- no unacceptable control situation is likely to result (see the provisions relating to 15 per cent limit on voting power in some entities in Division 1 of Part 7.4) (proposed paragraph 795B(1)(g)); and

- no disqualified individual appears to be involved in the applicant (see the 'fit and proper person' test in Division 2 of Part 7.5) (proposed paragraph 795B(1)(h)).

7.31 The criteria relating specifically to foreign operators of overseas markets are summarised separately below.

General obligations on a market licensee

7.32 The general obligations on a market licensee are described in proposed section 792A and build on the initial criteria, which are summarised above, but also bring in the appropriate element of action and continuity. For example, they require that a market not just have adequate procedures and rules to ensure the outcome specified, but take action with a view to achieving that outcome. This therefore encompasses enforcing the rules and procedures and keeping them under review.

7.33 In summary, the general obligations are:

- to the extent that it is reasonably practicable to do so, do all things necessary to ensure the market operates in a way that promotes the objectives of fairness, orderliness and transparency (proposed paragraph 792A(a));

- to comply with the conditions on the licence (proposed paragraph 792A(b));

- to have adequate supervisory arrangements (proposed paragraph 792A(c));

- to have sufficient resources to operate the market properly and provide for supervisory arrangements (proposed paragraph 792A(d));

- if compensation arrangements are required to be approved, to have approved compensation arrangements (proposed paragraph 792A(e));

- if the licensee is a foreign body corporate, to be registered as such under the proposed Corporations Act (proposed paragraph 792A(f));

- to take all reasonable steps to ensure that an unacceptable shareholder situation does not exist and that no disqualified individual becomes or remains involved in the licensee (proposed paragraph 792A(h) and (i)).

7.34 The particular obligations on foreign licensees are summarised separately below.

7.35 The approach of only including high level objectives in the law was adopted after consideration of the submissions received in response to the consultation paper. It also reflects the view of the Financial Sector Advisory Council that the legislation should provide flexibility to the regulator and extend the life of the legislation. The advantage seen by the Council was the speed with which regulations and guidelines could be changed to reflect the dynamics of the financial markets.

Fair, orderly and transparent

7.36 The ideal of a 'fair, orderly and transparent' market is reflected in proposed paragraph 792A(a), and hence in proposed paragraph 795B(1)(c).

7.37 The word 'transparent' is included in the light of the overwhelming support of Australian and overseas commentators for the value of a transparent market. These include Final Report of the FSI.

7.38 In interpreting the phrase ‘fairness, orderliness and transparency', it is desirable that all the words in the phrase be considered together. One word taken out of context may lead to a course of action which conflicts with the other words in the phrase. Thus, transparency may on occasions be in conflict with liquidity, yet liquidity is needed for an orderly market. The tensions between the three words need to be resolved sensibly, so that an appropriate balance is struck between the demands of different market participants. This is specifically acknowledged in the clause ‘to the extent that those objectives are consistent with one another’.

Conditions on the licence

7.39 At the time the licence is granted, conditions will be imposed on the licence.

7.40 These conditions must address (proposed subsections 796A(4) and (5)):

- the particular market that the licensee is authorised to operate;
- the class or classes of financial products that can be dealt with on the market;
- if the Minister considers that the licensee should have clearing and settlement facility arrangements for transactions effected through the market, the type of clearing and settlement facility arrangements that are adequate; and
- if compensation arrangements under proposed Division 3 of Part 7.4 are required, the minimum amount of the cover.

7.41 Other matters may also be addressed in conditions.

7.42 The procedure for imposing conditions, and varying or revoking existing conditions, is also described (proposed subsections 796A(1) to (3)).

7.43 The Minister may only impose conditions, or vary conditions on his or her own initiative if, among other things, the licensee has been given written notice of the proposed action and an opportunity to make a submission.

7.44 Conditions on a licence relating to the class or classes of financial product which may be traded will bring a flexibility which is impossible under the current regime. Under the Corporations Law, a futures exchange is basically limited to futures contracts, and certain other relevant agreements. A comparable limitation applies to securities exchanges.

7.45 The notion of a class of financial products is discussed below.

Supervisory arrangements

7.46 The market licensee is required to have arrangements for monitoring participants’ conduct in relation to the market and enforcing compliance with its operating rules (proposed paragraph 792A(c)).

7.47 The new provisions will include the possibility of:

- self-regulation;
- regulation by a related body corporate; or
- regulation by an independent supervisor.

7.48 The appropriate supervision arrangements will depend on the individual market. A particular structure may be more suited to one market than to another, depending on its size and nature. However, there must be adequate arrangements for handling conflicts between the commercial interests of the market licensee and its role in supervising particular participants or listed corporations. This requirement is considered necessary in the light of the demutualisation of exchanges here and overseas.

7.49 Possible structures include formal legal separation between the regulatory and commercial functions of the market operator or an independent compliance committee.

7.50 The criteria which independent supervisors would have to satisfy will not be included in the Act, because of the varieties of arrangements which are possible.

7.51 There will be no separate licensing process for market supervisors but the arrangement would need to be considered as part of the initial licence (and the ongoing obligations). This will include an assessment of the skills, resources (including human resources and computer systems) and experience which would be necessary to carry out the task.

7.52 The level of oversight by ASIC of markets will not necessarily vary depending on whether the market is self-regulatory or has an independent supervisor, but is expected to depend rather on the track record of the supervision, whichever route is taken.

7.53 In the light of the statutory role of ASIC, it is not appropriate that it exercise the level of supervision over market participants generally which is expected to be exercised by the market operator (or its independent supervisor).

7.54 The aim of the reforms is to facilitate efficiency, not to impose duplicated requirements. Thus it may be appropriate in certain situations for the supervision of two markets to be undertaken by the operator of one, or for the monitoring of clearing and settlement facility participants for compliance with the rules of the clearing and settlement facility to be undertaken by a related market licensee.

Sufficient resources

7.55 The operator must also have sufficient resources to operate the market in accordance with the legislative obligations, including providing for supervisory functions (whether they be self-regulation, or regulation by a related or independent body)(see proposed paragraphs 795B(1)(d) and 792A(d)).

7.56 This requirement refers to financial, technical and human resources.

Clearing and settlement facility arrangements

7.57 As indicated above, in considering the application the Minister may consider it appropriate that the applicant has adequate clearing and settlement facility arrangements for the transactions effected through the market (proposed paragraph 795B(1)(e)).

7.58 It is likely that he or she will reach such a conclusion in the majority of applications.

7.59 If the Minister considers that the licensee must have clearing and settlement facility arrangements for transactions effected through the market, the licence must include a condition specifying the type of clearing and settlement facility arrangements that are adequate (proposed paragraphs 796A(4)(c) and 792A(b)).

7.60 If the Minister considers that the licensee does not need clearing and settlement facility arrangements, the participants must be advised accordingly (proposed section 792G).

Compensation arrangements

7.61 The need for compensation arrangements is addressed in proposed paragraph 795B(1)(f) and section 792A(e).

7.62 There are two categories of compensation arrangements in Part 7.5:

- in relation to markets covered by the National Guarantee Fund;
- in relation to other markets.

7.63 In relation to the second group, compensation arrangements are required when the transactions of retail clients are being executed through the particular market and assets are being held by the participant for this purpose. The term 'retail client' is defined in proposed section 761G.

7.64 A market licensee may wish to make arrangements which exceed the minimum coverage required. To the extent that the arrangements exceed the minimum, they are relevant to the regulatory regime only to the extent that having that additional coverage impacts on the market's ability to meet the legislation's requirements.

7.65 A market licensee will be required to ensure that information about the compensation arrangements that are in place under Part 7.5 is available to the public free of charge (proposed section 792I). It is envisaged that this could be fulfilled by appropriate information being available on the market's Internet site.

The market's operating rules and procedures

7.66 The term 'operating rules' is defined in proposed section 761A and encompasses what are currently known as listing and business rules.

7.67 It should be noted that the term 'operating rules' is defined in section 761A in terms of conduct of the market or in relation to the market — to the extent that rules of a market operator cover other material, they would fall outside the definition.

What the rules and procedures must address

7.68 The subjects which a market must deal with in its procedures and operating rules will be prescribed by the regulations (proposed subsections 793A(1) and (2)).

7.69 This approach has been adopted to complement the high level criteria included in proposed sections 792A and 795B, and to delineate the issues which must be addressed in rules or procedures.

7.70 It is expected that the regulations will require such matters as access, rules about participants' conduct, disorderly trading conditions and the initial and continuing conditions under which particular products may be traded, to be addressed in the operating rules.

7.71 It is expected that the regulations will require issues such as links with other markets, recording and effective disclosure of transactions and mechanisms to ensure system integrity and security to be addressed in written procedures.

7.72 Draft regulations will be released for public comment in due course.

7.73 Proposed section 793A and the relevant regulations will therefore undertake the role of subsections 769(2), 770(2), 770A(2) and 1126(2) of the Corporations Law.

7.74 The need for contract protection procedures and mechanisms will be considered under, for example, proposed paragraphs 795B(1)(c) and 792A(a).

7.75 In the case of a market which provides an anonymous trading environment, some form of contract protection (satisfactory for the classes of product concerned) such as novation clearing or credit capping is likely to be necessary before its clearing and settlement arrangements will be considered adequate.

7.76 The public interest is required to be taken into account by the Minister in making certain specified decisions (including granting a market licence)(proposed paragraph 798A(2)(g)).

7.77 While the regulations will provide the basic list of matters to be included in rules and procedures, it is possible that additional rules and procedures will be required in particular circumstances to meet the test in proposed paragraphs 792A(a) and 795B(1)(c).

Effect of the operating rules, enforcement and disallowance

7.78 The provisions relating to operating rules have been consolidated. They relate to:

- the effect of the business rules (proposed section 793B);
- the enforcement of the operating rules (proposed section 793C); and
- the requirement to lodge amendments with ASIC and the power of the Minister to disallow them (proposed sections 793D and 793E).

7.79 These provisions are comparable to sections 772A, 774, 777, 1136 and 1140 of the Corporations Law.

7.80 Special mention needs to be made of two aspects of these provisions:

- as is currently the case (section 772A), the provisions render the business rules of the market as a contract under seal between the market licensee and each participant, and between a participant and each other participant (proposed section 793B).
  - this provision is needed to take account of the demutualisation of exchanges and to address the relationship between participants inter se. No comparable provision relating to the listing rules is necessary.
- while the grounds on which a Minister may disallow rule changes under section 774/1136 are currently not specified, proposed section 793E requires the Minister to have regard to the consistency of the changes with the licensee's obligations under Part 7.2, particularly the objectives of fairness, orderliness and transparency.

Other obligations on market licensees

Notification

7.81 The notification obligations fall into three categories:

- notification about the market licensee's own obligations;
- notification about participants in the market; and
- notification of information about listed disclosing entities.

7.83 Each is examined briefly below.

Notification about obligations on the licensee

7.84 The market licensee must notify ASIC:

- if it becomes aware that it may no longer be able to meet or has breached an obligation under section 792A (including a condition on its licence) (proposed subsection 792B(1));
- when it provides a new class of financial service incidental to the operation of the market (proposed paragraph 792B(2)(a)).

7.85 There are no comparable provisions in the existing Corporations Law. However, the provision of a new class of financial services which are incidental to the operation of the market, would, under the current legislation, require an exemption through the Corporations Regulations.

Notification about participants in the market

7.86 The market licensee must also:

- notify ASIC when the licensee takes disciplinary action against a participant or believes that the person is, for example, committing a serious contravention of the market's operating rules (proposed paragraphs 792B(2)(b) and (c));
  - These provisions reflect the current requirements in subsections 776(2) and (2A), and 1139(2) and (2A).
- provide a report to ASIC if it becomes aware of a matter relating to the ability of a financial services licensee who is a participant in the market to meet its obligations as such a licensee (proposed subsection 792B(3)).
  - This is intended to reflect the obligations currently found in section 862 of the Law. However, it has proved necessary to use regulations to supplement the provision because the subject matter currently in the sections referred to in subsection 862(2) will be found in regulations.

7.87 While it is clear that the requirements of proposed paragraphs 792B(2)(b) and (c) and proposed subsection 792B(3) will on occasions overlap, it is considered that they have sufficient independent operation to justify not melding them into one provision. Notifying ASIC twice will not be required if the conduct falls into the overlapping area — the one notification addressing the requirements of the relevant provisions would satisfy each of the applicable provisions. This is acknowledged in Note 1 to proposed section 792B.

7.88 If information is provided by a market licensee under a Memorandum of Understanding with ASIC, and the information is also required to be lodged under, say, proposed paragraph 792B(2)(b), then the requirement of that paragraph has been satisfied.

7.89 The proposed amendments relating to qualified privilege and protection from actions for breach of confidence are also relevant in this regard (see proposed Division 1 of Part 7.12).

7.90 Obligations specific to foreign licensees are considered below.

Notification about persons involved in the market

7.91 To complement the provisions of proposed Part 7.4, the market licensee will be required to provide ASIC with certain information about directors, secretaries and executive officers of the market licensee and those holding more than 15 per cent of the voting power of the licensee (or its holding company) (proposed subsection 792B(5)).

Notification about listed disclosing entities

7.92 The market licensee is also required to give ASIC any information about a listed disclosing entity which has been made available to participants (proposed section 792C).

7.93 However, the licensee is not required to give ASIC any information of a kind that is excluded by the regulations.

7.94 If the market has no listed disclosing entities, the obligation will not be triggered.

7.95 This provision reflects subsections 776(2B) and (2C) of the Corporations Law.

Assistance to ASIC

7.96 Market licensees will be required to:

- give such assistance to ASIC, or a person authorised by ASIC, as ASIC reasonably requests to perform its functions (proposed section 792D);
  - this provision is in substitution for subsections 776(1) and 1139(1) of the Corporations Law.
  - a request may be informal, in writing or oral, general or particular. A request is, however, necessary, so that the licensee knows what ASIC wants. Note that failure to comply with the request has criminal consequences.
- give a person authorised by ASIC reasonable access to the market's facilities for any of the purposes of Chapter 7 (proposed section 792E);
  - this provision reflects subsections 776(3) and (4), and 1139(4) of the Corporations Law.

Annual report

7.97 Each market licensee is required to provide ASIC with an annual report on the extent to which it has complied with its obligations under Chapter 7 (proposed section 792F).

7.98 The requirement and ancillary provisions permitting the Minister to require an audit report follow section 769C of the Corporations Law.

When an overseas market operator seeks an Australian market licence

7.99 The operator of a financial market which is authorised in a foreign country in which its principal place of business is located may:

- seek an Australian market licence under the criteria referred to above (proposed subsection 795B(1)); or

- seek an Australian market licence under proposed subsection 795B(2).

7.100 The purpose of the avenue provided in proposed subsection 795B(2) is to facilitate competition and avoid duplicated regulation, while paying due regard to investor protection and market integrity.

7.101 Whichever course is chosen, the operator will be required to be registered under Part 5B.2 (proposed paragraph 795B(3)(a)).

7.102 If the application is under proposed subsection 795B(2), the Minister may grant an Australian market licence authorising the applicant to operate the same market as is operated overseas if the Minister is satisfied that:

- the applicant has made an application, as required (proposed paragraph 795B(2)(a));
- the applicant can meet the obligations that will apply if the licence is granted (proposed paragraph 795B(2)(b));
- the operation of the market is subject to requirements and supervision in the country in which it is authorised that are at least equivalent to the Australian requirements, judged by the degree of investor protection and market integrity thus achieved (proposed paragraph 795B(2)(c));
- the applicant undertakes to co-operate with ASIC by sharing information and in other appropriate ways (proposed paragraph 795B(2)(d));
- no unacceptable control situation is likely to result (proposed paragraph 795B(2)(e));
- no disqualified individual appears to be involved in the applicant (proposed paragraph 795B(2)(f)); and
- any other requirements that are prescribed by the regulations for the purpose of this subsection are satisfied (proposed paragraph 795B(2)(g)).

7.103 There will be no requirement for reciprocal recognition of Australian markets in the country of origin of such applicants.

7.104 While most of the provisions of proposed Part 7.2 will apply to such markets, there are a number of provisions specific to markets with subsection 795B(2) licences. In summary, these are:

- the provisions relating to compensation arrangements will not apply (see proposed section 880A);
- the provisions relating to the contents of operating rules and procedures, and the disallowance of operating rules will not apply (see proposed subsection 793A(3)).
  - this is on the basis that the total regulatory requirements, including the vetting of procedures and rules, has been considered to be at least equivalent at the time the licence is granted, and on a continuing basis;
  - such a market licensee must, however, lodge changes of rules with ASIC so that the Australian regulator is in a position to assess the market's continuing compliance with the legislation (proposed subsection 793D(3));

- such a market licensee must also give written notice to ASIC if the licensee ceases to be authorised to operate in the overseas jurisdiction (proposed paragraph 792B(4)(a));

  – ceasing to be authorised to operate in the market in the jurisdiction of the operator's principal place of business and the Minister deciding that the overseas regime is no longer equivalent are grounds for the Minister to decide to suspend or cancel the Australian market licence (proposed paragraph 797B(d));

- the market licensee must notify ASIC of significant changes to the overseas regulatory regime to which it is subject (proposed paragraph 792B(4)(b)).

7.105 If a market operator with a subsection 795B(2) licence wishes to move its principal place of business to another country, it must obtain the Minister's approval (proposed section 792H).

7.106 If the principal place of business is moved to Australia, then the subsection 795B(2) licence is no longer appropriate and a licence under subsection 795B(1) would be required (proposed subsection 792H(2)). However, it is anticipated that the process would be streamlined to the extent that relevant matters had already been proved.

7.107 The factors to be taken into account in relation to decisions about a subsection 795B(2) licence include the arrangements for co-operation between ASIC and the foreign regulator (see proposed subsection 798A(3)).

Further powers of the Minister

The Minister's power to give directions

7.108 If the Minister considers that a market licensee is not complying with its obligations under Chapter 7, the Minister may give to the licensee a written direction to do specified things that the Minister believes will promote compliance by the licensee with those obligations (proposed subsection 794A(1)).

7.109 The market licensee is required to comply with the direction which may be enforced by Court order (proposed subsections 794A(2) to (3)).

7.110 The provision is comparable to section 769B of the Corporations Law.

The Minister's power to require a special report

7.111 The Minister is empowered to require a market licensee to give ASIC a special report on specified matters (proposed section 794B).

7.112 The Minister may also require the licensee to provide an audit report on the special report.

7.113 The licensee is required to give the special report and the audit report (if any) to ASIC within the time specified. ASIC then provides it to the Minister with advice.

7.114 This provision generally follows section 769D of the Corporations Law.

ASIC to assess licensee's compliance

7.115 ASIC will be empowered to do a written assessment of how well a market licensee is complying with its obligations under Chapter 7 — either a total assessment or an assessment of one or more of the obligations under Chapter 7 (proposed section 794C). Such an assessment of the

supervision arrangements must be undertaken at least once a year. This would include an assessment of the conduct of any party acting on behalf of the market licensee to fulfil the licensee's obligations — for example, as a supervisor as envisaged in paragraph 792A(c).

7.116 The legislation will not spell out the way the assessment is to be undertaken but indicates that reports from overseas regulatory authorities may be taken into account.

ASIC's role

ASIC's role recognised

7.117 ASIC's role in relation to the regulation of exchanges and clearing and settlement facilities is currently reflected to only a limited extent in the Corporations Law.

7.118 The proposed provisions will recognise the role of ASIC in assessing applications and amendments to operating rules, and otherwise providing advice to the Minister.

7.119 Proposed section 798B states that ASIC may give advice to the Minister in relation to any matter in respect of which the Minister has a discretion under Part 7.2, or any other matter concerning financial markets.

7.120 In addition, proposed paragraph 798A(2)(h) requires the Minister to have regard to any relevant advice received from ASIC in his or her assessment of applications and when considering, for example, the imposition of conditions on a licence and whether to disallow a change to the operating rules.

7.121 The Minister will be empowered to delegate his or her powers under this Chapter to ASIC (proposed section 1101J).

'Disorderly' markets

7.122 Currently, sections 775 and 1138 provide ASIC with certain powers to give directions in the case of 'disorderly' markets. The provisions contain some differences, section 1138 being more detailed and addressing the consequences for a clearing and settlement facility, as is more relevant to a futures exchange.

7.123 Proposed section 794D replicates the relevant parts of the current provisions:

- the prerequisite for this power is for ASIC to form the opinion that it is necessary, or in the public interest, to protect people dealing in a financial product or class of financial products (proposed subsection 794D(1));

- the purpose of referring in proposed paragraph 794D(1)(b) to 'other directions' is to empower the making of the directions to address a range of disorderly trading conditions;

  - the detail included in current section 1138 is not included in the new provision because of the range of products (and possible directions) which may be traded under the new regulatory regime;

  - however, examples are now provided under subsection 794D(1);

- the section allows for review by the Minister at any stage during the process (proposed subsection 794D(6)).

7.124 Proposed section 794E will empower ASIC to make ancillary directions to relevant clearing and settlement facilities. The purpose of this provision is to replicate the power currently included in paragraph 1138(7)(b)(ii) and subsection 1138(11) of the Corporations Law.

Matters to be taken into account by the Minister

7.125 The legislation will require the Minister to have regard to a number of factors when considering whether to grant an application, impose, vary or revoke conditions on a licence or disallow a change to the operating rules (proposed section 798A).

7.126 The factors include:

- the structure of the market;
- the nature of the products dealt;
- whether the transactions are undertaken directly by persons who would be categorised as retail or wholesale clients (see proposed section 761G);
- whether the transactions are undertaken on behalf of retail or wholesale clients; and
- whether it is in the public interest.

7.127 The factors listed in the proposed section provide assistance to markets (as well as the Minister) in working out how to satisfy the initial criteria and various obligations imposed by the regime on the market.

Public interest

7.128 In relation to 'public interest', it is noted that granting the licence could, for instance, increase competition, encourage product innovation or otherwise benefit market participants. It is envisaged that competing markets would be permitted provided that there is effective disclosure of information to promote transparency and the price formation process across a dispersed marketplace.

7.129 Generally speaking, OTC transactions will not take place on a market required to be licensed under Part 7.2.

7.130 Different regulatory requirements for OTC and formal markets are justified because the services and the promises offered in a formal market setting differ from those offered in relation to an OTC transaction.

7.131 The Final Report of the FSI stated, at page 282:

> *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.*

7.132 However, there is a clear need to ensure that regulation of financial markets is not excessive when compared to the regulation of financial service providers who are participating in OTC transactions. This will be taken into account, under proposed paragraph 798A(1)(g).

The licence's coverage

When a market participant needs its own Australian market licence

7.133 Where a participant in a market is conducting a market in its own right, then generally it should be regulated as a new market. In certain cases it may be appropriate to use the exemption power if, for example, the activities are sufficiently under the supervision of the relevant market. The original market should not be required to supervise the new market.

A new market or expansion of an existing one

7.134 A condition on the Australian market licence must specify the particular market that the licensee is authorised to operate and the class or classes of financial products that can be dealt with on the market (proposed paragraphs 796A(4)(a) and (b)).

7.135 The market licensee will not need to seek approval to quote a new product on the market but, depending on the classes of products referred to in the conditions, the licensee may need to seek approval if it wants to offer facilities for trading a new class of product (and may need to make additional operating rules relating to that class).

7.136 Examples of a class of financial product are securities and derivatives. The manner in which classes of financial products are described is not limited by the paragraphs of proposed section 764A. How a class of financial products is described is limited only by the imagination of the applicant and the decision-maker. There is no such thing as a product so innovative it cannot be described under this requirement. There is therefore no reason to believe that this requirement will cause 'silos under the licence, rather than on top'.

7.137 It is anticipated that the descriptions of classes of products in the conditions will be broadly phrased to reduce the need to seek amendments to the conditions. It is clearly desirable that no separate approval is required to permit the trading of each new index, for example.

7.138 The provision does not prevent a market being provided with a licence, which covers all financial products, or a very limited range of, for example, securities.

7.139 Whether a particular proposal involves a new market or an extension of an existing one will need to be determined by examination of the operation of the current market and the proposal in the light of the definition of financial market.

7.140 The reason for taking this approach is consistency with the initial application, which will require that particular criteria be addressed in relation to a particular market.

One licence, several markets

7.141 A licence may authorise the licensee to operate two or more financial markets. In that case, a reference in Chapter 7 to the market to which an Australian market licence relates is taken instead to be a reference to each of those financial markets severally (proposed section 795E).

When the market licensee also provides financial services

7.142 A market licensee will not need any additional approval or licence to provide financial services that are incidental to its market operation activities (proposed paragraph 911A(2)(d)).

7.143 However, in these circumstances, the market licensee must notify ASIC when it provides a new class of financial services (proposed paragraph 792B(2)(a)).

7.144 This avoids the need for an exempting regulation, which is the current mechanism.

7.145 On the other hand, if the financial services cannot be characterised as incidental to the market operation activities, then an Australian financial services licence will be required. Such a licence can be included in the same document as the Australian market licence (proposed section 795D).

When a market licensee also operates a clearing and settlement facility

7.146 The holder of an Australian market licence will need to obtain an Australian clearing and settlement facility licence before it operates a clearing and settlement facility as well as a financial market. The two licences may be included in the one document (proposed section 795D).

What can be done 'on-market'?

7.147 Nothing in these amendments should be read as limiting the dealings on a market to dealings in financial products. Thus trade in actual bullion, for example, would not be prohibited; nor would it be subject to regulation under this regime. However, the fact that significant trades in items that are not financial products are taking place on the market would have to be taken into account in assessing, for example, whether there are sufficient resources for and adequate supervision of the financial products aspect of the market.

Other matters

Variation, suspension and cancellation

7.148 The proposed provisions empower the Minister:

- to vary the licence to reflect a change of name (proposed section 797A);
- to immediately suspend or cancel a licence if the licensee ceases to carry on the business of operating the market, becomes externally-administered, asks the Minister to do so or, in the case of an overseas market, the overseas regulatory regime ceases to satisfy the equivalence criterion or the market ceased to be authorised in the overseas jurisdiction (proposed section 797B);
- to suspend or cancel the licence following a hearing and report, in other circumstances (proposed section 797C); and
- to vary or revoke a suspension (proposed section 797E).

7.149 The effect of suspension is addressed in proposed section 797D. The suspended licensee will remain subject to certain obligations, such as to give access to its facility to ASIC and to maintain compensation arrangements (if these were previously required). This will be achieved by empowering the Minister to specify in the notice the provisions, which will continue to apply.

7.150 An Australian market licence cannot be varied, suspended or cancelled otherwise than in accordance with these provisions (proposed section 797G).

7.151 Ancillary orders may, in some circumstances, need to be sought under section 1101B.

Self-listing of markets

7.152 A market licensee may be included in the market's official list. This may only be done in accordance with proposed section 798C, which corresponds with subsections 772B(1) to (5) of the Corporations Law.

7.153 Subsection 798C(2) imposes an obligation, which continues throughout the time when the financial products of the licensee are traded on its own market. This notion of continuity is reinforced by amendments to subsection (4).

7.154 In addition to the matters addressed in the current provision, the proposed provision addresses the possibility of self-listing by an overseas licensee (proposed subsection 798C(7)).

7.155 The power of ASIC to modify certain provisions of the Law as they apply to self-listing market licensees (or to exempt them from compliance) is included in proposed section 798D. This corresponds with subsections 772B(6) to (11) of the Corporations Law.

7.156 Fees are payable to ASIC for performing these functions — see Part 9.10. These will also be addressed in the proposed *Corporations (Fees) Act 2001*.

Other potential conflict situations

7.157 A new provision (proposed section 798E) has been inserted which will allow ASIC to take a role comparable to that under proposed section 798C where there is a conflict or potential conflict between the commercial interests of a market licensee and the licensee's role in supervising an entity listed on the market's official list or a participant on the market.

7.158 While it is envisaged that the usual method of addressing this situation will, in the future, be via independent supervision arranged by the market operator pursuant to proposed paragraph 792A(c)(i), it is considered desirable to provide an avenue whereby ASIC could undertake this function.

7.159 Again, fees will be payable to ASIC — see Part 9.10. These will also be addressed in the proposed *Corporations (Fees) Act 2001*.

Special ASX Provisions

7.160 Currently, the Corporations Law includes provisions which permit the ASX to change its company type and limit the holding of shares in the Exchange following the change to a company limited by shares (Part 7.1A).

7.161 Since the ASX has used the provisions in Division 1 of Part 7.1A and their operation is spent, it is appropriate that they be deleted. This will not affect the validity of actions taken under them while they formed part of the Corporations Law.

7.162 The provisions of Division 2 of Part 7.1A of the Corporations Law (limitations on holding shares in the ASX) have been omitted and replaced by new provisions relating to limitations on the voting power held in prescribed operators of financial markets and clearing and settlement facilities (or their holding companies) — see Division 1 of Part 7.4.

Gazettal

7.163 The following must be gazetted, but may take effect at an earlier date:

- the grant of an Australian market licence (proposed section 795C);

- the imposition of conditions, or additional conditions (or variation or revocation of conditions) on an Australian market licence (proposed subsection 796A(1));

- suspension, variation or revocation of suspension and cancellation of an Australian market licence (proposed section 797F); and

- an exemption or declaration by ASIC of the provisions applying to self-listing licensees (proposed subsection 798D(2)).

7.164 The following take effect on gazettal:

- an exemption under proposed subsection 791C(1);

- the imposition of a condition, or variation or revocation of conditions, or the revocation of an exemption under proposed subsection 791C(2).

Relevant matters in Part 7.12

7.165 The following are addressed in Part 7.12:

- qualified privilege and protection from actions for breach of confidence in various situations (proposed 1100A - 1100D);

- the effect on transactions of contravention of this Chapter (proposed section 1101H);

- application of the State/Territory gaming and wagering legislation to transactions relating to financial products (proposed section 1101I).

Appeals

7.166 Appeals from decisions of the Minister and ASIC may be made to the Administrative Appeals Tribunal (see Part 9.4A of the proposed Corporations Act).

8

Licensing of clearing and settlement facilities

Preliminary

8.1 As indicated previously, the objects of the Chapter are outlined in proposed section 760A. They should be read with ASIC's charter which is to be found in section 1 of the ASIC Act.

8.2 The purpose of proposed Part 7.3 is to provide a more flexible and comprehensive regime for the regulation of clearing and settlement facilities. Instead of the two routes to authorisation provided in the existing Corporations Law, there will be one.

8.3 Proposed Part 7.3 should be read in conjunction with proposed Division 4 of Part 7.11. Together these provisions omit the special position which the ASX's Securities Clearing House (SCH) currently holds in the Corporations Law and will permit access to the relevant transfer provisions by a wider range of facilities. The proposed provisions will permit (but not require) more than one clearing and settlement facility to handle the clearing and settlement of transactions executed on the one financial market. As a consequence of this, problems may arise about consistent treatment of the same issue by different facilities — this will need to be addressed but does not present a reason to retain provisions with an anti-competitive effect.

8.4 While the provisions in proposed Part 7.3 differ from those found in the current Parts 7.2A and 8.2, there is no intention to increase the regulatory burden on those clearing and settlement facilities currently regulated under those provisions.

8.5 A number of the new provisions reflect the new, more complete framework (for example, suspension of a licence) which are not addressed in the current provisions, rather than imposing additional obligations.

8.6 As to the comparability of the licensing regimes in proposed Parts 7.2 and 7.3, readers will notice that:

- the *framework* of the regulatory regime — such provisions as the application procedure, the manner in which conditions can be imposed and the power to suspend or cancel a licence — closely follows the market licensing regime in proposed Part 7.2;

- but the *obligations* which hang on that framework are designed to address the different services which a clearing and settlement facility provides.

8.7 As indicated in connection with Part 7.2, the approach has been taken of including only high level objectives in the Law. This reflects the view of the Financial Sector Advisory Council.

Allocation of responsibility

8.8 In brief, proposed Part 7.3:

- allocates different responsibilities to the Minister, ASIC and the clearing and settlement facility licensees respectively in pursuing the functions which they each have under the regulatory regime;

- in particular, the clearing and settlement facility licensee has the primary responsibility for determining how to ensure that the rules and procedures of the facility and their enforcement by the licensee are consistent with the provision of fair and effective service and reduce systemic risk;

- ASIC has primary responsibility for ensuring that participants on a facility comply with the Corporations Law and Regulations and exercises oversight of the licensee to ensure that it complies with its ongoing obligations;

- the Minister, with the advice and assistance of ASIC, has primary responsibility for the licensing of clearing and settlement facilities, as well as such associated matters as the suspension and cancellation of the licence, and determining whether the facility's operating rules are consistent with the licensee's obligations.

Provisions to be repealed

8.9 Proposed Part 7.3 will replace the following Parts of the Corporations Law:

- Part 7.2A (The Securities Clearing House);

- Part 8.2, Divisions 2 (clearing houses for futures exchanges) and 4 (to the extent it applies to clearing houses).

Definitions

8.10 A number of the relevant definitions are to be found in proposed Part 7.1 — for example, the definitions of 'clearing and settlement facility' and 'operating rules'.

Requirement to be licensed

The need for a licence

8.11 A person must not operate a clearing and settlement facility, as defined, unless they have an Australian clearing and settlement facility licence to operate the facility or the facility is exempt (proposed subsection 820A(1)).

8.12 The prohibition extends to holding out that the person has such a licence, operates a facility which is authorised, or that the facility is exempt (proposed section 820B).

8.13 Proposed section 820A will replace sections 779B and 1131 of the Corporations Law. However, it is noted that, in contrast to section 779B, the effect of the proposed provision is to require clearing and settlement facilities (as defined) to be licensed (or exempt).

8.14 Assisting in the operation of a financial market in contravention of proposed section 820A is covered by the Criminal Code and is therefore not explicitly mentioned in these provisions.

8.15 Strict liability will be applied to proposed paragraph 820A(1)(b) which provides that a person does not need a license to operate an exempt facility. The application of strict liability in this situation means that for an offence of operating a facility that is not exempt without a licence there is no burden on the prosecution to show that a defendant knew or was reckless as to whether the

facility was not exempt, a matter that it might otherwise be difficult to show that a defendant had considered. Strict liability has not been applied in relation to paragraph (a) as the prosecution would not have the same difficulty in showing that a person knew or was reckless as to the fact that they did not have a license.

8.16 For an offence under proposed section 820A and some other offences related to proposed Part 7.3, there are higher pecuniary penalties (up to 500 penalty units) than for equivalent offences in other parts of the Bill, this reflects the nature and size of bodies that are likely to be operating clearing and settlement facilities.

What is a clearing and settlement facility?

Proposed section 768A - What is a clearing and settlement facility?

8.17 The definition of clearing and settlement facility focuses on what may loosely be called the 'settlement' aspect of the process — that is, the provision of mechanisms by which the parties to financial product transactions meet their obligations arising from entering into the transaction.

8.18 In brief, a clearing and settlement facility is defined as a facility which provides a regular mechanism for the parties to transactions relating to financial products to meet obligations to each other which arise from entering into the transaction and are of a kind prescribed (proposed subsection 768A(1)).

8.19 Certain conduct is explicitly excluded from the definition (proposed subsection 768A(2)).

8.20 This definition thus includes, as the trigger for the obligations in Part 7.3, the one aspect of their functions which all clearing and settlement facilities which are to be regulated under these provisions perform, rather than attempting to refer to all the varied services performed by some clearing and settlement facilities.

8.21 Since the provisions may have application in connection with the settlement of a variety of financial products, it was considered inappropriate to specify in the proposed Corporations Act the obligations to be satisfied. This will be done by regulations.

8.22 To complement this approach, examples of the types of services which it is envisaged will satisfy this definition are now included in examples under proposed subsection 768A(1);

- the examples provided are just that - they give a general description in plain English of a facility which will meet the definition and do not address the finer points, for example whether the payment and delivery obligations are net or gross; whether the fulfilment of the payment and delivery obligations may or may not be simultaneous; whether or not novation is involved.

Definition of 'facility'

8.23 The word 'facility' is not defined. However, it is clearly not the intention to regulate as the operator of a financial market a person who merely operates an electronic means of communication or is just an Internet service provider. The operator of the means of communication would not itself be operating the market.

'Mechanism'

8.24 The 'mechanisms' which are referred to include technical infrastructure, regulations and procedures.

8.25 In the case of, for example, an association which co-ordinates the making of rules and procedures (relating to the clearing and settlement of transactions in relation to financial products) which are then adopted by its members, but which does not provide technical infrastructure or oversee compliance with the regulations, then the association would not be operating a clearing and settlement facility in the relevant sense.

8.26 The definition requires a 'regular mechanism'. This is consistent with the use of 'regularly' in the definition of 'financial market' in proposed section 767A.

'To meet obligations to each other'

8.27 It is not the intention or effect of the phrase 'to meet obligations to each other' to exclude from the definition clearing and settlement facilities which use novation — the obligations are initially between two parties and novation is a mechanism used by the clearing and settlement facility in dealing with those initial obligations.

8.28 Similarly, it is not the intention that proposed paragraph 768A(2)(b) take out of the definition clearing and settlement facilities which use novation.

What conduct is excluded?

8.29 The definition of 'clearing and settlement facility' will exclude:

- an ADI acting in the ordinary course of its banking business (proposed paragraph 768A(2)(a));
- a person acting on their own behalf, or on behalf of one party to a transaction and a broker dealing with its client's accounts in the ordinary course of its business activities (proposed paragraphs 768A(2)(b) and (c));
- clearing members (proposed paragraph 768A(2)(d));
- conducting treasury operations between related bodies corporate (proposed paragraph 768A(2)(e));
- the real time gross settlement system (proposed paragraphs 768A(f) to (h)) - this exclusion is in the same terms as in paragraph 765A(1)(i) to (k) from the definition of 'financial product'.
- other conduct prescribed by the regulations (proposed paragraph 768A(2)(i)).

Regulated activity

8.30 Activities of a licensee which are outside the scope of the conduct which the legislation regulates are the legitimate concern of the regulator to the extent that they are relevant to the core area of regulation (for example, where resources are diverted from the regulated conduct to the other businesses, or where the commercial imperative of those other businesses may conflict with the obligations imposed in relation to the regulated activity).

When is a clearing and settlement facility operating in this jurisdiction?

8.31 A clearing and settlement facility which operates in Australia will be caught by the new regime. The phrase 'operates in this jurisdiction' is not defined but is affected by proposed section 820D, which provides that the licensing regime will apply where the operator of the facility is incorporated in Australia, even if it only operates a clearing and settlement facility overseas

(proposed subsection 820D(1)). The reason for this extension is to ensure and safeguard Australia's reputation as a well-regulated jurisdiction.

8.32 This, however, will not limit the circumstances in which a clearing and settlement facility is operated in 'this jurisdiction' (that is, in Australia) for the purposes of Chapter 7 (proposed subsection 820D(2)). The provisions will thus cover facilities operated in Australia which process international transactions.

8.33 It is expected that mere accessibility by one or a few persons in Australia to a clearing and settlement facility based overseas would not be enough to constitute operating in Australia.

The power to exempt

8.34 The Minister will be empowered to declare in writing:

- a particular clearing and settlement facility; or
- a particular type of clearing and settlement facility;

to be exempt from the requirement to be licensed. The exemption may be subject to conditions (proposed subsection 820C(1)).

8.35 In addition, after the exemption has been declared, the Minister will be empowered to impose conditions, or additional conditions, vary or revoke conditions and revoke an exemption (proposed subsection 820C(2)).

8.36 The provision requires notice and an opportunity to make submissions before the Minister may take such action in relation to an existing exemption (proposed subsection 820C(3)).

8.37 The exemption power has been included as a precautionary measure. It will only be used where it is proved that a facility is within the definition but there is no satisfactory policy reason for regulating it as a clearing and settlement facility.

How to apply for an Australian clearing and settlement facility licence

8.38 The first step in applying for a clearing and settlement facility licence will be to lodge an application, which addresses the prescribed matters and is accompanied by the prescribed documents and fee, with ASIC (proposed subsection 824A(1)).

8.39 ASIC will then be required, within a reasonable time, to give the application to the Minister with its advice (proposed subsection 824A(2)).

When a clearing and settlement facility licence may be granted

8.40 Before the Minister may grant a licence under proposed section 824B(1), he or she must be satisfied that:

- the applicant has made an application, as required (proposed paragraph 824B(1)(a));
- the applicant can meet the obligations that will apply (these are described below) (proposed paragraph 824B(1)(b));
- the applicant has adequate rules and procedures (see proposed section 822A which is described below) for the facility to ensure, as far as is reasonably practicable, that systemic risk

is reduced and the facility is operated in a fair and effective way (proposed paragraph 824B(1)(c));

- the applicant has adequate supervisory arrangements (this is discussed further below) (proposed paragraph 824B(1)(d) — see Part 7.4);

- no unacceptable control situation is likely to result (proposed paragraph 824B(1)(e) — see Part 7.4);

- no disqualified individual appears to be involved in the applicant (proposed paragraph 824B(1)(f)).

General obligations on a clearing and settlement facility licensee

8.41 The general obligations on a clearing and settlement facility licensee are described in proposed section 821A and build on the initial criteria.

8.42 The general obligations, however, address the need to, for example, take action under the rules and procedures and keep them under review.

8.43 The general obligations are:

- to the extent that it is reasonably practicable to do so, do all things necessary to reduce systemic risk and to ensure the facility's services are provided in a fair and effective manner (proposed paragraph 821A(a));

  - in using the phrase 'reduce systemic risk', it is not the intention of the legislation to prohibit the expansion of services a clearing and settlement facility may provide or the size of its clearing and settlement business, but that the provision imposes an obligation to do all that is necessary to reduce the systemic risk inherent in the service it provides at any one time, and address this when it does change its business;

- to comply with the conditions on the licence (proposed paragraph 821A(b));

- to have adequate supervisory arrangements (proposed paragraph 821A(c));

- to have sufficient resources to properly operate the facility and carry out supervisory arrangements (proposed paragraph 821A(d));

- in the case of a foreign body corporate, to be registered as such under Part 5B.2 (proposed paragraph 821A(e));

- if prescribed for the purpose of Division 1 of Part 7.4, to take all reasonable steps to ensure that an unacceptable control situation does not exist (proposed paragraph 821A(g)); and

- to take all reasonable steps to ensure that no disqualified individual becomes, or remains, involved in the licensee (proposed paragraph 821A(h) - see Part 7.4).

8.44 The criteria relating specifically to foreign operators of clearing and settlement facilities are summarised separately below.

Conditions on the licence

8.45 At the time the licence is granted, conditions will be imposed on the licence.

8.46 These conditions must address (proposed subsection 825A(4)):

- the particular facility that the licensee is authorised to operate;
- the class or classes of financial products in respect of which the facility can provide services.

8.47 The paragraphs of this Explanatory Memorandum which discuss the concept of class of financial product in connection with financial markets apply equally in this context.

8.48 Other matters may also be addressed in conditions.

8.49 The procedure for imposing conditions, and varying or revoking existing conditions is also described (proposed subsections 825A(1) to (3)).

8.50 The Minister may only impose conditions, or vary conditions on his or her own initiative if, among other things, the licensee has been given written notice of the proposed action and an opportunity to make a submission (proposed subsection 825A(3)).

8.51 Conditions on a licence relating to the class or classes of financial product for which services may be provided bring a flexibility which is impossible under the current regime.

Supervisory arrangements

8.52 The clearing and settlement facility licensee is required to have arrangements for enforcing compliance with its operating rules and handling conflicts of interests.

8.53 The new provision (proposed paragraphs 821A(c) and 824(1)(d)) will include the possibility of a self-regulatory structure or oversight by an independent or related supervisor.

8.54 This does not mean that the regulatory scheme requires a clearing and settlement to take the same role in monitoring participants' conduct as an exchange does. What it does require is a mechanism by which participants' compliance with the operating rules and procedures is monitored and enforced. This requirement is thus linked to proposed paragraph 821A(a).

8.55 The criteria which independent supervisors would have to satisfy will not be included in the law because of the varieties of arrangements which are possible.

8.56 There will be no separate licensing process for the clearing and settlement facility supervisor but the arrangement would need to be considered as part of the initial licence (and the ongoing obligations). This will include an assessment of the skills, resources (including human resources and computer systems) and experience which will be necessary to carry out the task.

8.57 The aim is not to require duplication, but to facilitate efficiency. Thus it may be appropriate in certain situations for the supervision of a market and for the monitoring of clearing and settlement facility participants for compliance with the latter's rules to be undertaken by the one entity, for example, the market licensee.

8.58 There must also be adequate arrangements for handling conflicts between the commercial interests of the licensee and the need for the licensee to ensure that the facility's services are provided in a fair and effective way and that address systemic risk.

Sufficient resources

8.59 The clearing and settlement facility licensee must also have sufficient resources to operate the facility in accordance with the legislative obligations and provide for the supervisory functions (proposed paragraph 821A(d)).

8.60 This requirement refers to financial, technical and human resources.

8.61 Again, it needs to be pointed out that, in referring to 'supervisory functions', this requirement does not assume that the facility is undertaking the same monitoring role as an exchange. Instead, the phrase 'supervisory functions' is referring to the monitoring and enforcement role envisaged in proposed paragraph 821A(c).

The facility's operating rules and procedure

8.62 The term 'operating rules' is defined in proposed section 761A in terms of activities or conduct relating to the facility. To the extent that the rules cover other subject-matter, they will not be considered to be operating rules of the clearing and settlement facility for the purpose of this Chapter.

What they must address

8.63 The subjects which a facility must address in its procedures and operating rules will be prescribed by the regulations (proposed subsections 822A(1) and (2)).

8.64 This approach has been adopted to complement the high level criteria included in proposed sections 821A and 824B, and to delineate the issues which must be addressed in rules or procedures.

8.65 It is expected that the following will be amongst those included in the regulations as being required to be addressed in the operating rules:

- the regulated services provided and the procedure participants must follow to obtain them;
- measures to address risk including access, expulsion, suspension and disciplining and procedures which participants must follow to address the risks of relevance to the facility;
- if the clearing and settlement facility is prescribed under proposed Division 4 of Part 7.11, rules which make satisfactory provision for the financial products to be transferred under those provisions.

8.66 It is expected that certain aspects of risk management will also be required by the regulations to be addressed in procedures. These are likely to include:

- mechanisms to ensure clearing and settlement facility system integrity and security;
- identifying and monitoring risks of relevance to the facility, and developing rules (see above) and procedures to address them;
- procedures for the appropriate sharing with markets, other clearing and settlement facilities and ASIC of information about participants and their relevant activities;
- making available general information about the procedures of the facility, including the rights, obligations and exposures associated with the system.

- procedures for resolving complaints by facility participants about the services provided.

8.67 The systems and controls used will need to be appropriate for the scale and nature of the clearing and settlement facility's business.

8.68 Draft regulations are being prepared for public comment.

8.69 Proposed section 822A and the relevant regulations will therefore undertake the role of subsections 779B(2) and 1131(2) of the Corporations Law.

8.70 While the regulations will provide the basic list of matters to be included in rules and procedures, it is possible that additional rules, procedures or measures will be required in particular circumstances to meet the test in proposed paragraphs 824B(1)(c) and 821A(c). Thus contract protection procedures and mechanisms will not be specified in the regulations, but it is expected that they will be of relevance in the assessment of measures taken to reduce risks.

8.71 The phrase 'contract protection procedures and mechanisms' in this context includes, for example, margining, guarantee arrangements (that is, clearing house support, not the 'compensation arrangements' described in proposed Part 7.5), netting, position limits and capital requirements.

8.72 As indicated in relation to Part 7.2, in the case of a market which provides an anonymous trading environment, some form of contract protection (satisfactory for the classes of product concerned) such as novation clearing or credit capping is likely to be necessary before its clearing and settlement arrangements will be considered adequate.

8.73 The facility would also be expected to have links with participants, the trading system, the payment system, other clearing and settlement facilities (if, for example, there is more than one clearing and settlement facility operating for a given market), depositories and registries as appropriate to provide the regulated services offered.

8.74 The public interest is required to be taken into account by the Minister in making certain specified decisions, including granting a clearing and settlement facility licence (proposed paragraph 827A(2)(g)).

Effect of the operating rules

8.75 The provisions relating to operating rules have been collected. They relate to:

- the effect of the operating rules (proposed section 822B);
- the enforcement of the rules (proposed section 822C); and
- the requirement to lodge and power to disallow them (proposed section 822D and 822E).

8.76 These provisions are comparable to sections 779C, 779F, 779G, 1136 and 1140 of the Corporations Law.

8.77 While the grounds on which a Minister may disallow rule changes are currently not specified, the new provisions require the Minister to have regard to the consistency of the changes with the licensee's obligations under proposed Part 7.3, including the obligation to reduce systemic risk and to ensure the facility's services are provided in a fair and effective manner.

Other obligations on clearing and settlement facility licensees

Notification about obligations on the licensee

8.78 The clearing and settlement facility licensee must notify ASIC:

- if it becomes aware that it may no longer be able to meet or has breached one of the general obligations or has breached a condition of the licence (proposed subsection 821B(1));

- when it provides a new class of financial service incidental to the operation of the facility (proposed paragraph 821B(2)(a)).

8.79 There are no comparable provisions in the existing Corporations Law.

Notification about disciplinary action

8.80 The clearing and settlement facility licensee must also notify ASIC when the licensee takes disciplinary action against a participant (proposed paragraph 821B(2)(b)).

8.81 This provisions reflects the current requirements in section 779E and subsection 1139(2).

8.82 In addition, the licensee must notify ASIC if, for example, the licensee has reason to suspect that a person has committed a significant contravention of the facility's operating rules or the proposed Corporations Act (proposed paragraph 821B(2)(c)).

Notification about persons involved in the operator

8.83 In addition, the licensee must provide ASIC with details about persons involved in the operator (proposed subsection 821B(4)). This will support the provisions in proposed Part 7.4.

Overseas clearing and settlement facilities

8.84 The provisions of relevance to overseas clearing and settlement facilities which are licensed under proposed subsection 824B(2) are addressed separately below.

Assistance to ASIC

8.85 Clearing and settlement facility licensees will be required to:

- give such assistance to ASIC, or a person authorised by ASIC, as ASIC reasonably requires to perform its functions (proposed section 821C).

  – this provision reflects subsections 779D and 1139(1) of the Corporations Law.

- give a person authorised by ASIC reasonable access to the facility for the purposes of Chapter 7 (proposed section 821D).

  – this provision is comparable to subsections 776(3) and (5), and 1139(4) of the Corporations Law (which apply to securities and futures exchanges).

Annual report

8.86 Each clearing and settlement facility licensee will be required to provide ASIC with an annual report on the extent to which it has complied with its obligations under Part 7.3 (proposed subsection 821E).

8.87 The requirement and ancillary provisions permitting the Minister to require an audit report reflect section 769C of the Corporations Law, which currently applies only to securities exchanges.

8.88 If the one entity holds both a market licence and a clearing and settlement facility licence, then the annual reports required under both licences could be provided in the one document.

When an overseas clearing and settlement facility operator seeks an Australian clearing and settlement facility licence

8.89 The operator of a clearing and settlement facility which is authorised in the foreign country in which its head office is located may:

- seek an Australian clearing and settlement facility licence under the criteria referred to above (proposed subsection 824B(1)); or
- seek an Australian clearing and settlement facility licence under proposed subsection 824B(2).

8.90 The purpose of proposed subsection 824B(2) is to facilitate competition and avoid duplicated regulation, while paying due regard to such issues as systemic risk and the provision of services in a fair and effective way.

8.91 Whichever course is chosen, the operator will be required to appoint a local agent (proposed subsection 824B(3)). The provisions relating to the appointment and liability of local agents are found in Part 5B.2 of the Corporations Law.

8.92 If the application is under proposed subsection 824B(2), the Minister may grant an Australian clearing and settlement facility licence authorising the applicant to operate the same facility as is operated overseas if the Minister is satisfied that:

- the applicant has made an application, as required (proposed paragraph 824B(2)(a));
- the applicant can meet the obligations which will apply if the licence is granted (proposed paragraph 824B(2)(b));
- the operation of the facility is subject to legislative requirements and supervision in the country in which it is authorised which are sufficiently equivalent, in relation to the degree of protection from systemic risk and the level of effectiveness and fairness of services they achieve, to the Australian requirements (proposed paragraph 824B(2)(c));
- the applicant undertakes to co-operate with ASIC by sharing information and in other appropriate ways (proposed paragraph 824B(2)(d));
- no unacceptable control situation is likely to result and no disqualified individual appears to be involved in the applicant (proposed paragraphs 824B(2)(e) and (f) - see Part 7.4); and
- any other requirements which are prescribed by the regulations for the purpose of this subsection are satisfied (proposed paragraph 824B(2)(g)).

8.93 There will be no requirement for reciprocal recognition of Australian facilities in the country of origin of such applicants.

8.94 While most of the provisions of proposed Part 7.3 will apply to such facilities, there are a number of provisions specific to clearing and settlement facilities covered by subsection 824B(2) licences:

- in the case of an overseas clearing and settlement facility licensed under proposed subsection 824B(2), it is a continuing obligation that the facility remain authorised in the relevant foreign country and to obtain the Minister's approval before moving its principal place of business to another country (proposed paragraph 821A(f));

- the provisions relating to contents of operating rules and procedures do not apply (subsection 822A(3));

  – this is on the basis that the total regulatory requirements, including the vetting of procedures and rules, has been considered to be at least equivalent at the time the licence is granted, and on a continuing basis.

- amendments to the operating rules of such a facility are not disallowable, but must be lodged with ASIC, so that the Australian regulator is in a position to assess the facility's continuing compliance with the foreign regulatory scheme's substantial equivalence (proposed paragraph 822D(3));

- such a clearing and settlement facility licensee must also give written notice to ASIC if the licensee ceases to be authorised to operate in the overseas jurisdiction (proposed paragraph 821B(3)(a));

- the clearing and settlement facility licensee must notify ASIC of significant changes to the overseas regulatory regime to which it is subject (proposed paragraph 821B(3)(b));

  – ceasing to be authorised to operate in the facility in the jurisdiction of the operator's principal place of business and the Minister deciding that the overseas regime is no longer equivalent are grounds for the Minister to decide to suspend or cancel the Australian market licence (proposed paragraph 826B(d)).

8.95 If a market operator with a subsection 824B(2) licence wishes to move its principal place of business to another country, it must obtain the Minister's approval (proposed section 821F).

8.96 If the principal place of business is moved to Australia, then the subsection 824B(2) licence is no longer appropriate and a licence under subsection 824B(1) would be required (proposed subsection 821F(2)). However, it is anticipated that the process would be streamlined to the extent that relevant matters had already been proved.

8.97 The factors to be taken into account in relation to relevant decisions in relation to such a licence include the arrangements for co-operation between ASIC and the overseas regulator (see proposed subsection 827A(3)).

8.98 The purpose of the avenue provided in proposed subsection 824B(2) is to facilitate competition and avoid duplicated regulation while paying due regard to investor protection and integrity of the system.

Further powers of the Minister

The Minister's power to give directions

8.99 If the Minister considers that a clearing and settlement facility licensee is not complying with its obligations under Part 7.3, the Minister may give to the licensee a written direction to do specified things that the Minister believes will promote compliance by the licensee with those obligations (proposed subsection 823A(1)).

8.100 The clearing and settlement facility licensee is required to comply with the directions, which may be enforced by Court order (proposed subsection 823A(2) to (3)).

8.101 The provision is comparable to section 769B in the Corporations Law, which currently applies to securities exchanges.

The Minister's power to require a special report

8.102 The Minister is empowered to require a clearing and settlement facility licensee to give ASIC a special report on specified matters (proposed section 823B).

8.103 The Minister may also require the licensee to provide an audit report on the special report.

8.104 The licensee is required to give the special report, and the audit report (if any) to ASIC within the time specified. ASIC then provides it to the Minister with advice.

8.105 This provision generally follows section 769D of the Corporations Law, which currently applies only to securities exchanges.

ASIC's role

ASIC's role recognised

8.106 ASIC's role in relation to the regulation of exchanges and clearing and settlement facilities is currently reflected to only a limited extent in the Corporations Law.

8.107 The proposed provisions will recognise the role of ASIC in assessing applications and amendments to operating rules and otherwise providing advice to the Minister.

8.108 Proposed section 827B states that ASIC may give advice to the Minister in relation to any matter in respect of which the Minister has a discretion under Part 7.3, or any other matter concerning clearing and settlement facilities.

8.109 In addition, proposed paragraph 827A(2)(h) requires the Minister to have regard to any relevant advice received from ASIC in his or her assessment of applications and when considering, for example, the imposition of conditions on a licence and whether to disallow a change to the operating rules.

8.110 The Minister will be empowered to delegate his or her powers under this Chapter to ASIC (proposed section 1101J).

ASIC assessments of compliance

8.111 ASIC will be empowered to undertake an assessment of how well a clearing and settlement facility licensee is complying with its obligations under Chapter 7 (proposed section 823C). It will

be required to undertake an assessment in relation to the obligations included in proposed paragraph 821A(c) annually.

8.112 The legislation will not spell out the way the assessment is to be undertaken but indicates that any information and reports received from an overseas regulatory authority.

Directions power

8.113 Proposed section 823D provides ASIC with a power to give directions to a clearing and settlement facility:

- the triggers are that ASIC considers that it is necessary, or in the public interest, to protect people dealing in a financial product or a class of financial products, or the failure of the licensee to do all things reasonably practicable to ensure the facility's services are provided in a fair and efficient manner (proposed subsection 823D(1));

- the direction power is limited to transactions of which the licensee receives notice after the direction takes effect;

- the provision includes a requirement for notice of the opinion and an 'appeal' mechanism to the Minister (proposed subsection 823D(7)).

8.114 A second directions power, which is limited to situations where the facility has not done all things reasonably practicable to reduce systemic risk in the provision of the facility's services is also included — see proposed section 823E.

8.115 An example of a direction under these provisions follows:

> *ASIC may direct a clearing and settlement facility to close out of all positions, or otherwise deal with, outstanding positions held by participant A so that the financial position of other participants in the markets in which A participated is not jeopardised by A's failure to meet his obligations.*

Matters to be taken into account by the Minister

8.116 The legislation requires that the Minister have regard to a number of factors when considering whether, for example, to grant an application, impose, vary or revoke conditions on a licence or disallow a change to the operating rules (proposed section 827A).

8.117 The factors include:

- the nature of the products for which services are provided; and

- the technology used.

8.118 The factors listed in the proposed section provide assistance to facilities (as well as the Minister) in working out how to satisfy the initial criteria and various obligations imposed.

The licence's coverage

What services can be provided by a clearing and settlement facility licensee?

8.119 Nothing in these amendments should be read as limiting the services, which a clearing and settlement facility licensee can provide. To the extent that such services fall outside this regulatory

regime, they will not be regulated and are only relevant to the regulator to the extent that their provision may detract from the facility fulfilling its obligations in relation to regulated services.

When the clearing and settlement facility licensee also provides financial services

8.120 A clearing and settlement facility licensee will not need any additional approval or licence to provide financial services that are incidental to its facility's activities (proposed paragraph 911A(2)(d)). This is currently addressed in paragraph 779J(1)(a) of the Corporations Law.

8.121 However, in these circumstances, the licensee must notify ASIC when it provides a new class of financial services (proposed paragraph 821B(2)(a)).

8.122 On the other hand, if the financial services cannot be characterised as incidental to the facility's activities, then an Australian financial services licence will be required.

When a clearing and settlement facility licensee also operates a market

8.123 A clearing and settlement facility licensee will need to obtain an Australian market licence before it operates a financial market. The two licences may be included in the one document (proposed section 824D).

More than one facility in the same licence

8.124 A licence may cover more than one clearing and settlement facility (proposed section 824E). Special provisions apply in relation to varying the conditions on such a licence to add another facility, and in relation to suspending or cancelling such a licence.

Other matters

Variation, suspension and cancellation

8.125 The proposed provisions empower the Minister:

- to vary the licence to reflect a change of name (proposed section 826A);
- to immediately suspend or cancel if the licensee ceases to carry on the business of operating the facility, or becomes externally-administered, or asks the Minister to do so (proposed section 826B);
- to suspend or cancel the licence following a hearing and report, in other circumstances (proposed section 826C); and
- to vary or revoke a suspension (proposed section 826E).

8.126 The effect of suspension is addressed in proposed section 826D. It is likely that the suspended licensee will remain subject to certain obligations, such as to give access to its facility to ASIC. This will be achieved by empowering the Minister to specify in the notice the provisions, which will continue to apply.

8.127 An Australian clearing and settlement facility licence cannot be varied, suspended or cancelled otherwise than under these provisions (proposed section 826G).

Gazettal

8.128 The following must be gazetted, but may take effect at an earlier date:

- the grant of an Australian clearing and settlement facility licence (proposed section 824C);
- the imposition of conditions, or additional conditions (or variation or revocation of conditions) on an Australian clearing and settlement facility licence (proposed subsection 825A(1));
- suspension, variation or revocation of suspension and cancellation of an Australian clearing and settlement facility licence (proposed section 826F).

8.129 The following take effect on gazettal:

- an exemption under proposed subsection 820C(1);
- the imposition of a condition, or variation or revocation of conditions, or the revocation of an exemption under proposed subsection 820C(2).

Relevant matters in proposed Part 7.12

8.130 The following are addressed in proposed Part 7.12:

- the effect on transactions of contravention of this Chapter (proposed section 1101H);
- qualified privilege and protection from actions for breach of confidence in various situations (proposed Division 1 of Part 7.12).

Appeals

8.131 Appeals from decisions of the Minister and ASIC may be made to the Administrative Appeals Tribunal (see Part 9.4A of the Corporations Law).

9

Limits on involvement with licensees

9.1 This Part contains two Divisions which separately address:

- limits on voting power in prescribed licensees (or their holding companies) (Division 1);
- the need for individuals involved in all market and clearing and settlement facility licensees to be fit and proper (Division 2).

9.2 In brief, these provisions differ from the current regulatory scheme in the following respects:

- by applying a voting power limitation to a wider class of licence-holders than the current 5 per cent shareholding limitation which applies only to the ASX; and
- by including a new 'fit and proper person' test, in line with international developments in the regulation of exchanges and clearing and settlement facilities.

Rationale

9.3 Structural changes to the ownership and organisation of exchanges (especially those resulting from demutualisation) have indicated new issues for their regulation.

9.4 The most significant issue in this regard is to ensure the maintenance of the integrity of the market operated by the relevant exchange. That integrity may come under pressure for a number of reasons, not the least of which is the danger (real or perceived) that the operation of the market may be compromised to suit the vested interests of large shareholders or senior managers.

Division 1 — Limit on control of certain licensees

9.5 In the light of these considerations, the Government decided to retain a shareholding limitation and to extend its application to operators of financial markets and clearing and settlement facilities which are of national significance (see proposed section 850A).

9.6 The licensees of such markets and clearing and settlement facilities, or their holding companies will be prescribed. This structure has been adopted, despite the use of the concept ‘voting power’, so that the controlling entity (for example, where a licensee is a 100 per cent wholly-owned subsidiary) is prescribed. The provisions do not prejudge which company in a group will hold the relevant licence.

9.7 The ownership limitations (and the legislative scheme embodied in Division 1) are comparable to those included in the *Financial Sector (Shareholding) Act 1998*.

National significance

9.8 Guidelines will be issued indicating the matters which will be taken into account in assessing whether or not a market or clearing and settlement facility is considered to be of national significance.

9.9 The guidelines contain the following:

- the significance to the national economy of the functions performed by the financial market or clearing and settlement facility;
- the size and importance of the financial market or clearing and settlement facility both within the Australian financial services industry and relative to other operations providing a similar service or function;
- the degree of, or potential for, competition between the financial market or clearing and settlement facility and other already prescribed financial markets or clearing and settlement facilities.

The 15 per cent limitation

9.10 The limit of 15 per cent voting power (proposed section 850B, and section 610) in prescribed entities is an increase from the current 5 per cent limit on holdings in the ASX (see Division 2 of Part 7.1A).

9.11 The 5 per cent limit is considered unduly restrictive in raising further capital. In addition, the higher level will not inhibit the entering into of alliances between markets (which may involve equity participation) in the same way as the 5 per cent limitation. Low shareholding limits also have the effect of insulating management from the normal pressures that come with having a free market for ownership and control.

9.12 Subdivisions A and C of Division 1 therefore include:

- a prohibition on acquisitions which result in an 'unacceptable control situation' (see proposed sections 850B and 850C);
- an anti-avoidance provision (proposed section 852B);
- provisions empowering the Court to make orders where there is an unacceptable control situation (proposed sections 850D and 850E), so long as the order does not offend paragraph 51(xxxi) of the Constitution (proposed section 852A).

Approval to exceed 15 per cent voting power

9.13 Division 1 also includes provisions which will empower the Minister to approve applications to hold more than 15 per cent of the voting power of a prescribed entity if he or she is satisfied that it is in the national interest (see proposed sections 851A-851H). This power to increase the 15 per cent ownership limitation is included so that, for example, the range of partnership options in the future is not fettered. The proposed provisions cover the following:

- making an application to exceed the 15 per cent limitation (proposed section 851A);

- granting or refusing such an application (proposed section 851B) and revoking an approval (proposed section 851F);
- the duration of the approval (proposed section 851C);
- conditions on an approval (proposed section 851D);
- varying the percentage approved (proposed section 851E); and
- seeking further information about an application (proposed section 851G).

9.14 The Minister is required to make a decision within 30 days after receiving such an application (proposed subsection 851H(1)).

9.15 Time does not run while a request for further information (proposed section 851G) is outstanding (proposed subsection 851H(4)) and the period in which the decision must be made may be extended to 60 days (proposed subsection 851H(2)).

9.16 However, if the Minister fails to make a decision within the time limit, he or she is taken to have granted what was applied for (proposed subsection 851H(3)), unless an unacceptable control situation exists (proposed subsection 851H(5)).

Breach of a condition

9.17 In connection with the breach of a condition on an approval, it should be noted that:

- a failure to inform ASIC of a breach of a condition is an offence (proposed subsection 851D(8)); and
- the contravention of a condition will empower the Minister to revoke the approval (see proposed paragraph 851F(1)(c)).

Relationship with initial requirements for a licence and ongoing obligations

9.18 The Minister is required to be satisfied that no unacceptable control situation will result when an application for a licence under Part 7.2 or 7.3 is under consideration (proposed paragraphs 795B(1)(g), 795B(2)(e), 824B(1)(e) and 824B(2)(e)).

9.19 The licensee is also required to take all reasonable steps to ensure that an unacceptable control situation does not exist (proposed paragraphs 792A(h) and 821A(1)(g)).

Relationship with the Foreign Acquisitions and Takeovers Act 1975

9.20 The requirements of Division 1 of Part 7.4 operate independently of the requirements of the *Foreign Acquisitions and Takeovers Act 1975*.

Division 2 — Individuals who are not fit and proper are disqualified

9.21 The ‘fit and proper person’ test included in the FSR Bill is designed to ensure that only appropriate people are associated with the management, ownership and control of all financial markets and clearing and settlement facilities which are the subject of Australian licences.

9.22 The test will operate as an initial probity check for the ASIC to apply and is comparable to those applied in a number of overseas jurisdictions in this context. In particular, the 'fit and proper person' test will allow consideration of issues of propriety by assessing integrity and suitability in the light of, for example, criminal records, civil suits, sanctions applied by regulators or questionable practices.

9.23 The test will apply whether or not the operator of the market or clearing and settlement facility has been prescribed for the purposes of Division 1 of proposed Part 7.4.

9.24 It does not address professional competence — this issue is considered under proposed paragraphs 792A(1)(d) and 821A(1)(d) in the course of considering an application for a licence and as an ongoing obligation.

Who is involved in the operator of a financial market or clearing and settlement facility?

9.25 In brief, the provisions apply to directors, executive officers and secretaries of the licensee and its holding company, and those with over 15 per cent voting power (see the description of who is 'involved in' an operator and therefore subject to the test in proposed section 853B).

Who is disqualified?

9.26 There are three tests to determine whether a person is disqualified (proposed section 853A):

- two tests are objective:
  - disqualification from managing a corporation under section 206B;
    : section 206B refers to insolvent persons and persons who have been convicted of certain offences - for example, for serious fraud or on indictment in connection with the promotion, formation or management of a company;
  - being on ASIC's Register under section 1274AA;
    : the Register under section 1274AA contains the names of persons whom a Court (and in certain situations, ASIC) has ordered not to manage a corporation.
- the third limb empowers ASIC to declare that an individual is disqualified after a hearing and report (the procedure required is described in proposed sections 853C-E).

Relationship with initial requirements for a licence and ongoing obligations

9.27 These matters are also addressed in the context of the application for a licence (see proposed paragraphs 795B(1)(h), 795B(2)(f), 824B(1)(f) and 824B(2)(f)), and subsections 795B(4) and 824B(4)).

9.28 Division 2 also imposes obligations on disqualified individuals not to become involved in a market or clearing and settlement facility licensee and to cease to be so involved (proposed section 853F).

9.29 Comparable obligations are imposed on the licensee by proposed paragraphs 792A(i) and 821A(h).

9.30 To assist the licensee, ASIC is required to inform the licensee if it becomes aware that an individual involved in it is disqualified (proposed section 853G).

Record-keeping and information

9.31 Division 3 of proposed Part 7.4 empowers the making of regulations requiring that records relevant to Part 7.4 requirements be kept and information provided (proposed section 854A).

10

Compensation regimes for markets

Summary

10.1 Proposed Part 7.5 addresses:

- the National Guarantee Fund (NGF) and its administration (which is currently regulated under Part 7.10 of the Corporations Law) (proposed Division 4); and

- requirements for compensation arrangements which certain other markets will be required to make (that is, cover accessible by a retail client for specified losses of property entrusted to a participant in a financial market) (proposed Division 3);

  – the comparable provisions are currently found in Parts 7.9 and 8.6 of the Corporations Law.

  – the aim of Division 3 of Part 7.5 is to provide better targeted compensation arrangements which can be provided by a market in a variety of ways.

10.2 In this regard it is necessary to separate consideration of clearing and settlement system support. This is addressed in proposed Part 7.5 only to the extent that the NGF currently provides this type of support. It is, however, referred to more generally in Part 7.3.

10.3 The aim of the compensation arrangements required by proposed Part 7.5, particularly Division 3 arrangements, is to provide investors in appropriate circumstances with protection from certain losses. They will not be required to pursue other possible avenues of redress first (and this includes those mechanisms required of financial services licensees).

Division 2 — when there must be a compensation regime

10.4 Licensed markets through which participants provide services for retail clients must have compensation arrangements where the participants hold property on behalf of those clients (proposed section 881A).

10.5 This needs to be addressed in the licence application (proposed section 881B).

10.6 The applicant may state that the market will be covered by the NGF. If the Minister is satisfied that the market will be covered by the NGF, then he or she may grant the licence (proposed section 881D).

10.7 On the other hand, the applicant may have made its own compensation arrangements which will be considered under proposed Division 3 of Part 7.5 (see proposed section 881C, 882A and 882B).

10.8 Proposed Part 7.5 will not apply to overseas markets seeking a licence under proposed subsection 795B(2) on the basis that, if appropriate, the compensation arrangements of the overseas market will be considered in reaching a decision whether to grant the licence (proposed section 880A).

10.9 The current coverage of the NGF in relation to the ASX's markets is expected to be little changed.

Division 3 — approved compensation arrangements (other than the NGF)

10.10 In brief, the differences between the compensation arrangements required under proposed Division 3 and the current requirements under Parts 7.9 and 8.6 of the Corporations Law are:

- the proposed Division 3 arrangements require coverage only for retail clients, while the current Parts 7.9 and 8.6 of the Law do not distinguish between wholesale and retail clients;
- the proposed Division 3 arrangements tie the loss to a transaction on the market, not to the firm's business of dealing in securities or futures contracts as the current provisions do;
- while Parts 7.9 and 8.6 require a fidelity fund, under proposed Division 3 a greater range of mechanisms will be acceptable and it will be up to the market as to how these are funded.

10.11 The proposed Division 3 arrangements require coverage for loss arising from fraud or defalcation, as do Parts 7.9 and 8.6. Since the Division 3 arrangements are the minimum, particular market operators may wish to provide, in addition to the required coverage, coverage for loss for the client of a participant arising from the effect of the participant's insolvency on funds or financial products held on the client's behalf.

Retail clients

10.12 The aim of these provisions is to provide protection to retail clients, while allowing greater flexibility to markets as to how to provide the compensation.

10.13 The term ‘retail client’ is defined in proposed section 761G.

10.14 It will be a matter for the business judgment of the operator as to whether the compensation arrangements are also accessible by wholesale clients.

10.15 To the extent that they are available to wholesale clients, the arrangements are not subject to this regulatory regime except to the extent, if any, to which they may impact on the adequacy of the arrangement for retail clients.

10.16 Access to the compensation arrangements may therefore be limited in the case of a retail investor whose order is passed from a financial planner to a participant in the market.

10.17 The focus on retail investors is consistent with the views expressed in the FSI Report.

Approval

10.18 As indicated above, if the relevant market needs to have compensation arrangements under Division 3, it will need to include the relevant information in its application (proposed paragraph 881B(2)(c)). It will then be considered for approval under proposed section 882A.

10.19 Proposed section 882B addresses the procedure for obtaining approval of compensation arrangements after the licence has been granted.

10.20 The Minister will also be empowered:

- to revoke an approval (proposed section 882C); and
- if the Minister forms the view that the licensee's approved compensation arrangements are no longer adequate, to give a written direction to do specified things so that the arrangements become adequate once more (proposed section 882D).

Connection with market

10.21 Currently, Parts 7.9 and 8.6 do not require that the property be received by the broker in connection with a transaction on the exchange which is required to pay the claim from its fidelity fund.

10.22 Subsection 907(1), for example, currently refers to property that was entrusted ‘in the course of or in connection with that member's or firm's business of dealing in securities’.

10.23 This is considered inappropriate in an age where the one person may be a participant on a number of markets and clearing and settlement facilities.

10.24 The proposed provisions therefore require that, in the case of compensation arrangements for financial markets (see proposed paragraph 885C(1)(b)), the property or authority over property was given to the participant in connection with effecting a transaction covered by provisions of the operating rules of the market relating to on-market transactions.

10.25 This will align the coverage of the compensation arrangements with the area of participants' conduct for which the market has some responsibility.

10.26 It is the intention therefore that the provisions will cover funds held in anticipation of margin calls, but not, for example, loans to participants.

10.27 The need for the necessary connection with a particular market is also addressed in proposed section 885D. In this connection, it should be noted that, even though, for example, the client may provide the one cheque to a financial service provider in connection with an arrangement that the financial service provider enter into several transactions on behalf of the client, each amount attributable to a separate transaction is considered a separate loss.

10.28 If a loss is not a Division 3 loss (and the market is not subject to Division 4 arrangements), then the client will be left to pursue the financial service provider, who is required to have adequate compensation arrangements (see proposed section 912B).

Defalcation or fraud

10.29 It is not necessary that the person against whom defalcation or fraud is alleged has been convicted or prosecuted; nor does it matter that the evidence on which the claim is allowed would

not be sufficient to establish guilt (proposed subsection 885C(2)). This follows current subsections 911(7) and 1243(7) of the Corporations Law.

Ex-participants

10.30 The compensation arrangements are required to cover relevant losses caused by the fraud or defalcation of certain ex-participants (see proposed paragraph 885C(1)(a)(ii)). This follows subsections 907(12) and 1239(10) of the Corporations Law.

Adequate compensation arrangements

10.31 Proposed Subdivision D of Division 3 describes what are adequate compensation arrangements (proposed 885B). They are:

- compensation rules which provide adequate coverage for Division 3 losses, the amount of the compensation, how it is to be paid and the making and determination of claims and notification of the outcome of claims (proposed paragraphs 885B(1)(a) to (d));
- arrangements which provide for an adequate source of funds and arrangements for administration and monitoring (proposed paragraphs 885B(1)(e) and (f));
- under the arrangements, potential claimants have reasonable and timely access to the compensation regime (proposed paragraph 885B(1)(g)); and
- run-off arrangements (proposed paragraph 885B(1)(h)).

10.32 The requirements referred to in proposed paragraphs 885B(1)(a) to (f) are then described in greater detail in proposed sections 885C to 885I.

10.33 In considering these matters, the Minister must also have regard to the matters mentioned in proposed section 885J (proposed subsection 885B(2)). They are:

- the services provided by the market and by the participants in it; and
- any risk assessment report in relation to the market given to the Minister under proposed section 892K.

Amount of compensation

10.34 Under Division 3, the compensation rules must provide that the amount of compensation to be paid is not less than the actual pecuniary loss plus reasonable costs and disbursements in making and proving the claim (proposed section 885E).

10.35 The provisions also address:

- rights of set-off (proposed subsection 885E(2));
- caps on payments (proposed subsections 885E(3) and (4));
- the payment of interest (proposed subsection 885E(5)); and
- the procedure to be adopted where there are insufficient funds (proposed subsection 885E(6)).

10.36 The compensation rules must also deal with how compensation in respect of Division 3 losses is to be paid. This may be in a lump sum or instalments (proposed section 885F).

Exclusions

10.37 The compensation arrangements under Division 3 may exclude losses of a kind described above. However, the compensation arrangements will not be adequate unless the Minister is satisfied that those exclusions are appropriate (proposed subsection 885C(3)).

10.38 It will be appropriate to consider under this provision arrangements which, for example, permit or require the rejection of claims by persons referred to in the definition of 'excluded persons' in section 921 (for example, the person whose conduct has caused the loss, or his or her spouse).

10.39 Only one claim can be paid in relation to the one loss (proposed section 886A). This will ensure that a person may not make a claim in relation to a derivatives transaction and the underlying securities.

Source of funds

10.40 There must be an adequate source of funds available to cover the claims made (proposed section 885H). The source is not specified.

10.41 If a market needs funds to, for example, increase its fidelity fund or assist in paying for other compensation arrangements, then it will be able to levy its participants through its rules. Such levies are supported by proposed section 883D and a proposed new levies bill which is expected to be introduced in the next sitting. The procedure which these provisions require is included for constitutional reasons.

Limitation on access to other funds to satisfy compensation claims

10.42 Proposed section 883C is comparable with section 915 of the Corporations Law which limits the source of funds for compensation claims.

The fidelity funds of defunct or merged facilities

10.43 How a fidelity fund or part of a fidelity fund (if the fund is shared) is dealt with in, for example, the event of a market merging with another market or ceasing to carry on business as such will be addressed in the regulations (proposed section 886B).

10.44 This mechanism would appear desirable given the wide range of possible situations — from the demise of a small market to the merger of major markets.

Use of rules and changes to arrangements

10.45 In order to provide markets with a greater role in defining the terms of the compensation arrangements, a number of matters are required to be included in compensation rules rather than being included in the Corporations Law (see proposed paragraphs 885B(1)(a) to (d) for a summary).

10.46 These rules are thus analogous to the operating rules of the market or facility. Provisions relating to their effect, enforcement and amendment are included (proposed sections 883A, 883B and 884B).

10.47 Proposed paragraphs 885B(1)(e) to (f) also indicate that there are other requirements which do not need to be in the rules.

10.48 These will be able to be changed in accordance with proposed section 884C. The intention is to require approval for major matters, but not minor administrative changes (see proposed section 884A).

Division 4 - National Guarantee Fund

10.49 Part 7.10 of the Corporations Law currently regulates the NGF. This Part will be replaced by proposed Division 4 of Part 7.5.

Nomination of the SEGC

10.50 The nomination of the Securities Exchanges Guarantee Corporation (SEGC), currently in the *Corporations Act 1989*, will be included in Part 7.5 (proposed section 890A). A transitional provision is expected to preserve the current nomination.

Application of Division 4

10.51 Division 4 of Part 7.5 applies in relation to markets operated by a body corporate that is a member of the SEGC (or a subsidiary of such a member) other than those that the regulations state are not covered by this Division (proposed section 887A). The purpose of the proviso is to provide flexibility in the future, not to exclude any particular market now.

Moving the heads of claim into the regulations

10.52 The proposed provisions foreshadow moving the heads of claim into the regulations (see proposed sections 888A to 888E). The regulations will provide for:

- the situations in which compensation may be claimed;
- the kinds of compensation available;
- the amount of compensation available;
- the way in which it is to be paid; and
- the making and determination of claims.

10.53 Moving these matters into the regulations will provide flexibility to adjust the heads of claim in line with changes in the procedure of the members of the SEGC (currently only the ASX) and to reflect changes in the products that may be traded on their markets.

10.54 Many of the amendments to Part 7.10 which were put forward during the consultation process related to Divisions 6-8. These proposals will be taken into account in the drafting of the regulations. However, it is envisaged that there will be no significant changes to the actual compensation cover provided currently by the NGF, apart from those foreshadowed above.

10.55 The significant changes to the provisions currently included in Part 7.10 of the Law are summarised below.

Levies to support the NGF

10.56 The procedure included in proposed sections 889J and 889K is included for constitutional reasons. Consequential amendments to the proposed *Corporations (National Guarantee Fund Levies) Act 2001* are expected to be introduced in the next sitting.

Payment out of NGF to prescribed body

10.57 It may be appropriate, at some time in the future, for the proportion of the NGF attributable to 'clearing house support' to be paid to the appropriate arm of the ASX, thus confining the role of the NGF to 'investor protection' claims.

10.58 Proposed 891A will empower the Minister to make such a decision if he or she is satisfied that the relevant body had made adequate arrangements for covering all or part of the clearing and settlement system support that is provided for by Division 4 of Part 7.5 or the relevant regulations**.**

10.59 In considering such an application the Minister will also have regard to the adequacy of the remaining funds for the claims which remain payable out of the NGF (proposed subsection 891A(4)).

10.60 Conditions may be imposed in connection with such a direction (proposed subsections 891A(2) and (3)).

SEGC rules

10.61 While section 928 of the Corporations Law provides for SEGC business rules, it is understood that there are currently no rules which the SEGC considers fit this description.

10.62 Rather than omitting the concept, it has been retained and brought into line with the comparable market/clearing and settlement facility provisions by including provisions relating to the effect and enforcement of the rules (proposed sections 890D to 890H).

10.63 It is possible that, at some future time, it may be appropriate for the procedural aspects of handling to claims to be included in the rules, rather than in the regulations (see proposed section 888E).

10.64 Proposed subsection 888E(4) will ensure that, to the extent of any inconsistency, the regulations override the rules.

Other changes in the NGF/SEGC provisions

10.65 Many of the provisions relating to the SEGC and the operation of the NGF are not changed in any significant way. However, proposed Division 4 does include various minor amendments — for example:

- elaborating the provisions relating to SEGC business rules;
- providing greater flexibility in the payment of costs;
- omitting the purposes for which payments are to be made out of the interest and profits on the NGF;

- providing greater flexibility in relation to delegation by the SEGC; and
- drafting improvements.

10.66 Proposed Division 4 retains the possibility that additional bodies corporate will become members of the SEGC (proposed sections 891B).

Common provisions

10.67 Division 5 of proposed Part 7.5 addresses some issues which are of relevance both to the NGF provisions and the Division 3 arrangements.

10.68 They include:

- how regulated funds (a term defined in proposed section 892A) are to be kept (proposed section 892B);
- investment of money in regulated funds (proposed section 892C);
- the powers of relevant authorities to require production or delivery of financial products, documents or statements (proposed section 892D);
- accounting and reporting in relation to regulated funds and where the compensation does not come out of a regulated fund (proposed sections 892H and 892I);
- the relevant authority's right of subrogation when compensation has been paid (proposed section 892F);
- the capacity to require a risk assessment report to be prepared (proposed section 892K);
  - the nature of the report required would be specified in the notice;
- the issues addressed below.

Power to require assistance

10.69 The SEGC and those with relevant responsibilities in relation to Division 3 compensation arrangements will be empowered to require assistance from the relevant market (proposed section 892E).

10.70 The power in relation to the SEGC relates to dealing with a claim or the assessment of risks to the NGF. A comparable power is provided in relation to Division 3 arrangements.

Excess funds

10.71 Division 5 of Part 7.10 currently provides for the Securities Industry Development Account. Funds which exceed the minimum amount in the NGF may be paid by the SEGC Board to the ASX. The ASX is required to keep the money in a separate account designated as a securities industry development account and may only make a payment out of it for a purpose approved by the Minister (or back into the NGF).

10.72 Under proposed section 892G, such a mechanism will be available in relation to any fidelity fund, as well as the NGF.

10.73 Rather than including detailed provisions in the Corporations Law, proposed section 892G provides that the regulations:

- may determine or provide a method for determining when there is excess money in a regulated fund;

- may make provision in relation to how excess money in a regulated fund may be dealt with.

10.74 The regulations may make different provision in relation to different funds.

10.75 It is expected that the regulations will indicate that excess money in a regulated fund may be used:

- for financial industry development purposes;

  – such payments will only be able to be made for a public benefit and must not be used to promote the profitability of commercial operations of any market;

  – examples are investor education activities that improve awareness of the functions of particular financial products and the functioning of Australia's financial markets;

- to pay premiums for fidelity insurance or other compensation arrangements of the relevant market.

Qualified privilege

10.76 Qualified privilege is provided in limited circumstances under current Parts 7.9, 7.10 and 8.6 — see, for example, subsections 910(3), 969(4), 982(3) and 1242(3).

10.77 Proposed section 892J empowers the making of regulations for specified persons to have qualified privilege in respect of specified things done under compensation rules forming part of Division 3 arrangements, or under regulations for the purpose of Division 4 (NGF).

10.78 It is anticipated that the regulation-making power will be used to provide protection comparable to that currently provided.

10.79 In addition, the SEGC has qualified privilege under proposed subsection 888J(3) in respect of the publication of a statement about the coverage of an insurance contract.

Risk assessment report

10.80 The Minister is empowered to require the operator of a financial market to cause a risk assessment report to be prepared in relation to the market and to provide that report to the Minister (proposed section 892K). Such a report would be relevant to an assessment of the adequacy of the compensation arrangements proposed or in place.

Holding clients' funds

10.81 Part 7.8 of the Corporations Law (deposits with stock exchanges) will be repealed and its provisions not re-enacted. Proposed Part 7.8 addresses the obligations of financial services licensees relating to dealing with clients' money.

11

Licensing of providers of financial services

11.1 This Part outlines the prerequisites for providing financial services in Australia. In particular, it details how a person may obtain a financial services licence, and the obligations imposed on financial services licensees.

11.2 Proposed Part 7.6 replaces licensing requirements currently contained in:

- Chapters 7 and 8 of the proposed Corporations Act;
- the *Insurance (Agents and Brokers) Act 1984*; and
- the *Superannuation Industry (Supervision) Act 1993*.

Preliminary

11.3 Proposed Division 1 defines 'representative' for the purposes of this Part to include an authorised representative of the licensee, an employee or director of the licensee, an employee or director of a related body corporate of the licensee, or any other person acting on behalf of the licensee.

Requirement to be licensed or authorised

11.4 The requirement for a person to be licensed or authorised is set out in proposed Division 2. A person who carries on a financial services business in this jurisdiction must hold an Australian Financial Services Licence covering the provision of the financial services. The terms 'person' and 'financial services business' are defined in proposed Part 7.1.

11.5 The concept of 'carrying on a financial services business' in this jurisdiction is affected by proposed section 911D (see below) and by Division 3 of Part 1.2 of the existing Corporations Law. For the purposes of the new Chapter 7, paragraph 21(3)(e) of the Law will not apply. The common law meaning of 'carrying on a business' encompassing elements of system, repetition and continuity suggests that one-off transactions relating to the provision of financial services and financial products are unlikely to be caught by the new regime.

11.6 Proposed subsection 911A(2) sets out various exemptions from the requirement to hold a financial services licence. In a prosecution under this provision, a defendant would have an evidential burden in relation to showing that they were exempt. The following persons are exempt from holding a licence:

- representatives of a licensee whose licence covers the provision of the service;

- representatives of a person who is exempt from the requirement to hold a licence;

- product issuers who merely issue, vary or dispose of a product where a second person (a licensee or representative of a licensee) offers to arrange for the issue, variation or disposal of the product and the product was issued to the client, varied or disposed of in accordance with this arrangement;

- product issuers who vary or dispose of a product at the direct request of the client who holds the product. This exemption recognises that clients may on their own initiative seek to vary or cancel a product without utilising the services of an intermediary, and the fact that the client merely exercises the features of a product – variation or cancellation – does not warrant licensing of the product issuer. In contrast, where a product issuer, for example, provided financial advice in relation to variation or cancellation, a licence would be required;

- financial market or clearing and settlement facility operators who provide a financial service incidental to the operation of a licensed financial market or clearing and settlement facility. Market operators must be licensed under Part 7.2 and a clearing and settlement facility operators must be licensed under Part 7.3;

- a service provider who is a member of a declared professional body - the declared professional body provisions are contained in Division 7 of Part 7.6;

- receivers, managers, administrators and personal representatives of deceased persons (including deceased financial services licensees);

- APRA regulated bodies that provide financial services only to wholesale clients. The rationale for requiring the licensing of service providers who only provide services to wholesale clients is to ensure market integrity. Where such service providers are regulated by APRA or an approved overseas regulatory authority, market integrity objectives are met;

- persons regulated by approved overseas regulatory authorities that provide financial services only to wholesale clients;

- persons who provide services only to related bodies corporate;

- trustees of self-managed superannuation funds who provide services in that capacity;

- exemptions prescribed in regulations or specified by ASIC.

11.7 These exemptions from the requirement to hold an Australian Financial Services Licence do not apply if the service provided is the operation of a registered managed investment scheme.

11.8 Proposed section 911B prohibits a person from providing financial services on behalf of another person (the principal) who carries on a financial services business except in the following situations:

- employees and directors of a licensee;

- employees and directors of a related body corporate of a licensee. While these persons will not require authorisation, the relevant licensee will continue to be responsible for the competence and conduct of these individuals;

- authorised representatives of a licensee;

- employees of authorised representatives of a licensee, where the service provided is a basic deposit product or facility for making non-cash payments that is related to a basic deposit product;

- licensees whose licence covers the provision of the service. Note however that in general a financial services licensee cannot be the authorised representative of another financial services licensee (see proposed sections 916D and 916E);

- principals exempt under proposed subsection 911A(2);

11.9 Proposed section 911C prohibits persons from holding out that they have a licence, are exempt from the requirement to hold a licence, act on behalf of another person in providing a service, or that their conduct is within authority granted by a particular licensee, unless that is the case.

11.10 Proposed section 911D is relevant to determining when a financial services business is taken to be carried on in this jurisdiction for the purposes of Chapter 7. It provides that a person is carrying on a financial services business where they intend to induce people in this jurisdiction to use the financial services the person provides, or their actions are likely to have that effect. This provision is intended to make it clear that service providers who target Australians from overseas, by whatever means (including internet and telephone), will be taken to carry on a financial services business in this jurisdiction and will therefore require an Australian financial services licence and be subject to the obligations attaching to that licence. Proposed section 911D does not limit the circumstances in which a financial services business is carried on in this jurisdiction.

Obligations of financial services licensees

General obligations

11.11 A financial services licensee must during the currency of their licence meet the general obligations outlined in proposed section 912A to:

- provide those financial services covered by the licence competently and honestly;

- comply with any conditions imposed by ASIC on the licence;

- take reasonable steps to ensure that its representatives comply with the requirements of the Act (including obligations under proposed Parts 7.6, 7.7 and 7.8) and any other law of the Commonwealth, a State or a Territory that relates to the provision of financial services. In order to satisfy this requirement, it is anticipated that a licensee would need to actively monitor and supervise the activities of its representatives to ensure compliance.

- maintain sufficient financial, technological and human resources to properly provide financial services and supervise representatives;

- maintain competence, skills and experience to provide financial services;

- ensure representatives are adequately trained and are competent to provide financial services;

- have internal and external dispute resolution procedures to handle complaints from retail clients. These procedures must be approved by ASIC in accordance with regulations;

- have adequate risk management systems (unless the licensee is an APRA-regulated body); and

- comply with all other requirements imposed on licensees under the Act, and any other prescribed obligations.

11.12 Proposed sections 912B to 912F impose further obligations on licensees to:

- have arrangements for compensating retail clients (where they provide financial services to retail clients) for losses or damage suffered through a breach of the obligations imposed by Chapter 7 on licensees and their authorised representatives. These arrangements must be in accordance with the regulations or be approved in writing by ASIC. It is intended that the regulations will set minimum standards for these compensation arrangements. Due to the wide range of business activities that will be undertaken by licensees, the compensation arrangements that will be required will vary significantly depending on the type of financial services which the licensee provides;

- comply with a direction of ASIC to provide a written statement or audit report to ASIC;

- notify ASIC of an inability to meet, or a breach of, an obligation under proposed sections 912A or 912B, and notify ASIC where the licensee becomes a participant in a licensed market or licensed clearing and settlement facility (or ceases to be such);

- give assistance to ASIC as requested, in relation to whether the licensee and its representatives are complying with the Act;

- include the licensee's licence number in all documents in which the licensee identifies itself in connection with providing financial services under the licence. At the time an application for a licence is granted, ASIC must give the licensee a unique licence number (see proposed section 913C). The offence for contravening this provision is strict liability due to the technical nature of the offence, the need to ensure effective enforcement and in view of the lower pecuniary penalty that applies.

Australian financial services licences

11.13 Proposed Subdivision A outlines how to obtain a licence. To apply for a licence a person must lodge with ASIC an application under proposed section 913A, together with the prescribed information and any prescribed documents. The classes of persons who may be granted a licence have been extended from natural persons and bodies corporate to include partnerships. This extension has been intended to provide industry participants with greater flexibility in the way they structure their activities.

11.14 ASIC must grant the licence if:

- the application was made properly;

- ASIC has no reason to believe that the applicant will not comply with licensee's obligations;

- ASIC is satisfied that the person (if a natural person) is of good character or (if a body corporate) the applicant's responsible officers are of good character. ASIC must have regard to convictions for serious fraud in the last 10 years, suspension or cancellation of an Australian financial services licence, and banning and disqualification orders under Division 8; and

- the applicant meets any other prescribed requirements.

11.15 ASIC must give the applicant an opportunity to be heard before refusing to grant a licence.

11.16 Subdivision B allows ASIC to impose conditions on the licence. ASIC may at any time impose, vary or revoke conditions on a licence, under proposed section 914A. However, ASIC must first give the licensee an opportunity to make submissions and give evidence at a private hearing.

11.17 Where the licensee is regulated by APRA, ASIC must consult with APRA before imposing any or additional conditions, or varying conditions. This is intended to prevent unnecessary duplication of regulation by the two regulators. ASIC's power to vary or revoke conditions does not extend to conditions prescribed by regulation.

11.18 If the licensee is an ADI and the proposed condition would have the result of significantly limiting or restricting the ADI's ability to carry on all or any of its banking business, then ASIC does not have the power to impose the condition, and the power to impose, vary or revoke such a condition are taken to be powers of the Minister (proposed subsection 914A(5)).

11.19 Proposed Subdivision C outlines when ASIC may vary, suspend or cancel a licence. Provisions 915A to 915J are modelled on existing Corporations Law sections 824 to 827 but have been rewritten to, among other things, take account of the scope of persons who may obtain a licence under the new financial services licensing provisions.

11.20 Proposed subsection 915I provides for consultation with APRA in relation to APRA regulated bodies and situations relating to ADIs where the power to suspend a license is not ASIC's but the Minister's. This provision operates in a similar way to the imposition of conditions discussed above.

Authorised representatives

11.21 Under proposed section 916A, a financial services licensee may authorise a person to provide a financial service or financial services on its behalf by giving the person a written notice. Representatives may be authorised to provide all of the services covered in a principal's licence or a subset of those services.

11.22 Natural persons, bodies corporate and partnerships may be authorised representatives. This represents a change from the existing Corporations Law which prohibits a body corporate from acting as a representative. This new approach will provide authorised representatives with greater flexibility and will accommodate existing representative structures.

11.23 An authorisation may be revoked by a licensee at any time by written notice.

11.24 Authorised representatives are prohibited from authorising persons to act as their representative or as a representative of the licensee under proposed section 916B. Where a body corporate is authorised as the representative of a licensee, it may give an individual a written notice authorising that individual to provide specific financial services on behalf of the licensee, but only if the licensee consents.

11.25 Proposed section 916C permits an authorised representative to act for more than one licensee but only where each person has consented to the person also being the representative of each of the other licensees, or each of those licensees is a related body corporate of each of the other licensees.

11.26 As a general rule, a financial services licensee is prohibited by proposed section 916D from acting as the authorised representative of another financial services licensee. The only circumstances in which this may be permitted is where a binder exists in relation to financial services provided in relation to insurance (proposed section 916E). This exception will allow the continuation of current industry practice. 'Binder' is defined in proposed section 761A to mean an authorisation given to a person by a financial services licensee who is an insurer, to either enter into risk insurance contracts of the insurer as insurer, or deal with and settle risk insurance claims against the insurer as insurer. This definition is based on section 9 of the IABA.

11.27 Financial services licensees are required by proposed section 916F to notify ASIC within 10 business days of authorising a representative or revoking the authorisation of a representative. The notice provided to ASIC must include the authorised representative's contact details, details of the authorisation, and details of any other financial services licensee for whom the representative is authorised to act.

11.28 In a prosecution for a contravention of proposed subsection 916F(3), strict liability applies to the circumstance that an authorised representatives' details have changed. This will effectively place a greater onus on licensees keep track of changes in the details of authorised representatives and will allow for effective enforcement of the provision.

11.29 Proposed section 916G outlines circumstances in which ASIC may give information to a financial services licensee about a person whom ASIC believes is, or will be, an authorised representative of the licensee. The provision also outlines what use may be made of the information.

Liability of financial services licensees for authorised representatives

11.30 Financial services licensees are responsible for the conduct of representatives (including employees or directors of the licensee, authorised representatives of the licensee and any other person acting on behalf of the licensee) that relates to the provision of financial services on which a client could reasonably be expected to rely and on which the client relied in good faith (proposed section 917A). Under proposed section 917E, the responsibility of licensees extends to liability for any loss or damage suffered by a client as a result of the conduct of representatives.

11.31 The liability provisions cover circumstances in which a representative acts for only one licensee and circumstances in which a representative acts for multiple licensees. The joint and several liability provisions that apply where there are multiple licensees have been modelled on provisions in the IABA but have been modified to confine liability to circumstances in which the conduct of the representative is clearly attributable to one or a sub-set of licensees.

Responsibility if representative of only one licensee

11.32 Where a representative acts for only one licensee, that licensee is responsible under proposed section 917B for the conduct of the representative, whether or not the representative's conduct was within authority.

11.33 Within authority is defined in proposed section 917A to mean, in the case of an employee — within the scope of their employment; in the case of a director — within the scope of their duties as a director; in any other case — within the scope of the authority given by the licensee.

Representatives of multiple licensees

11.34 Where a representative acts for more multiple licensees, those licensees will be responsible as follows:

- where a person is the representative of multiple licensees, but is representative of only one of those licensees in respect of a particular class of financial service to which the conduct relates — that licensee is responsible, whether or not that conduct is within authority, and any other licensees for whom the representative acts will not be responsible (proposed subsection 917C(2));

- where a person is the representative of multiple licensees, and is the representative of more than one of those licensees in respect of a particular class of financial service to which the conduct relates, and the conduct is within authority in relation to only one of those licensees - that licensee is responsible, and any other licensees for whom the representative acts will not be responsible (proposed subsection 917C(3));

- in all other cases, all of the licensees are jointly and severally responsible for the conduct, whether or not the representative's conduct is within authority in relation to any of them (see proposed subsection 917C(4)).

11.35 However, a financial services licensee is not responsible under proposed sections 917B or 917C for the conduct of their representative where the representative clearly disclosed to the client, before the client relied on the conduct, that the conduct was not within authority (see proposed section 917D).

11.36 The effect of these provisions is to give the client the same remedies against the licensee that the client has against the representative (proposed subsection 917F(1)). However, it does not impose any criminal liability or any additional civil liability under a provision of the proposed Corporations Act (other than that Division).

11.37 The provisions do not relieve representatives of any liability they may have to a client, according to proposed subsection 917F(4). Nor do the provisions prevent licensees from entering into agreements with representatives providing that the representatives indemnify the licensee for any liability of the licensee in respect of the representative (proposed subsection 917F(6). A licensee for whom a representative acts may also indemnify another licensee in respect of the representative (proposed subsection 917F(6)).

Declared professional bodies

11.38 Division 3 provides a mechanism for professional bodies, whose members may give financial product advice in the course of carrying on their profession, to come within the licensing regime. This mechanism recognises that some industry participants such as accountants, lawyers and actuaries are already subject to a range of strict professional requirements, including competence and ethical standards and are subject to disciplinary procedures where they breach those standards.

11.39 Where members provide financial services other than advice - for example dealing — a licence or authorisation from a licensee will be required. The declared professional body (DPB) mechanism does not extend to dealing as:

- unlike financial advice, dealing is not an activity that has historically been an aspect of the relevant professions; and

- given that the DPB mechanism is a first step along the path of self-regulation in this area, it seems prudent to limit its scope until the success of the measure may be assessed.

11.40 This mechanism has not been inserted as an alternative to incidental advice. The general refinement of the definition of financial product advice will ensure that a distinction is clearly drawn between advice that falls within the financial services reform regime and advice that falls outside.

11.41 Once advice falls within the regime then it is appropriate from a regulatory neutrality point of view that the standards imposed by the regime are met irrespective of who is providing that advice — whether they be accountants, solicitors, actuaries, insurance agents, or securities dealers. The DPB mechanism and the licensing mechanisms are the two means by which these standards are imposed.

Applying for a declaration

11.42 A professional body may apply to ASIC for a declaration to be made under proposed section 918B (see proposed section 918A). ASIC may declare that a professional body is a DPB if ASIC has no reason to believe that the body will not comply with the obligations that will apply to it if the declaration is made.

11.43 In assessing the adequacy of the above requirements it is anticipated that ASIC would consider the requirements applying to licensees.

Variation and revocation of declaration

11.44 Proposed section 918C sets out the circumstances in which ASIC may vary or revoke a declaration, including the circumstances in which the DPB must be given an opportunity to be represented at a hearing and to make submissions. The section also sets out requirements for the form in which the body is notified of variation or revocation and the requirement for ASIC to furnish a statement of reasons for the action taken. To ensure that the interests of clients are protected in the event of variation or revocation of a declaration, ASIC may specify that certain provisions of the declaration continue as though the variation or revocation had not happened.

Conditions on declaration

11.45 Under proposed section 918D, ASIC may impose, vary or revoke conditions on a declaration. However, ASIC must first give the body an opportunity to make submissions and attend a hearing in relation to the matter.

Obligations of declared professional bodies

11.46 Subdivision B sets out the obligations on DPB. These essentially replicate the general obligations imposed on financial services licensees under proposed section 912A, with the following additions — the DPB must:

- have adequate powers to discipline or remove members;
- ensure that adequate conduct and disclosure requirements apply to members of the body; and
- have adequate arrangements for compensating clients for loss or damage suffered through any breach of obligations.

11.47 The Bill also requires DPBs to:

- provide a statement to ASIC when directed to do so (proposed section 919B); and
- notify ASIC of certain matters — namely, a breach or impending breach of an obligation under the Act, or disciplinary action against a member of the body (proposed section 919C);
- provide assistance to ASIC where the regulator is checking on compliance with the Act (proposed section 919D); and
- establish and maintain a register of members (proposed section 919E).

Banning or disqualification of persons from providing financial services

11.48 Proposed sections 920A to 921A provide ASIC with powers to ban or disqualify persons from providing financial services. These provisions are modelled on existing provisions (sections 828-836, 838, 1192A-1199A, and 1201 of the Corporations Law), but have been rewritten to take into account the scope of the new provisions.

Registers relating to financial services

11.49 ASIC will establish and maintain a register of financial services licensees, authorised representatives and DPBs, and make the register available for public inspection without charge (proposed sections 922A and 922B).

11.50 This approach to the keeping of registers represents a change for participants currently operating under the Corporations Law, which requires ASIC to maintain a register of licence holders and licensees to keep a register of proper authority holders.

11.51 The new regime will result in the consolidation of information about licensees and authorised representatives, and will streamline access for people who seek information about these classes of people. It also obviates the need for licensees to provide ASIC with information about the number of persons who are authorised representative of the licensee. Therefore, existing Corporations Law requirements relating to licensee annual statements have not been carried over to the new regime. Further, given the disclosure obligations in the Bill, Part 7.7 of the existing Corporations Law relating to registers of interests in securities has also been omitted from the new regime.

Restrictions on the use of terminology

11.52 The Bill restricts the use of certain words and expressions by financial service providers. It will be an offence for a person to use the words ‘independent’, ‘impartial’ or ‘unbiased’ (or like words or expressions) unless:

- the person and, where relevant, their employers or associates do not receive commissions, remuneration based on volume bonus, or gifts or benefits from product issuers which may reasonably be expect to influence the person;
- the person in providing financial services operates free from any direct or indirect restrictions on the financial products in respect of which they provide financial services (restrictions imposed by way of licence conditions are not direct of indirect for the purposes of these provisions); and

- the person operates without any conflicts of interest that might otherwise be created by their associations or relationships with product issuers that might reasonably be expected to influence the person in providing financial services (proposed section 923A).

11.53 It will be an offence under proposed section 923B for a person to use the restricted words listed below, or like words or expressions, unless ASIC authorises the use of the word or words by way of a condition on a licensee's licence. The restricted words and expressions are:

- 'Stockbroker' or 'sharebroker';
- 'Futures broker';
- 'Insurance broker' or 'insurance broking';
- 'General insurance broker';
- 'Life insurance broker';
- any other expression prescribed by the regulations.

11.54 ASIC will only be able to authorise the use of these words if the licensee is permitted, under the licence, to provide a financial service relating to either securities, futures or contracts of insurance. The licensee must also be a participant in a licensed financial market, or must act on behalf of the intending insureds, as relevant.

Agreements with unlicensed persons

11.55 Proposed sections 924A to 925I provide a range of protections to clients who enter into agreements with unlicensed persons. These provisions do not apply to people who are exempt from holding a financial services licence, so they apply only to people who are not licensed, but should be.

11.56 These provisions are modelled on existing Part 7.3, Division 2 of the Corporations Law, and have been amended to reflect the scope of the new regime.

12

Financial services disclosure

Preliminary

12.1 Proposed Part 7.7 imposes obligations on financial services licensees and authorised representatives to provide prescribed disclosure documents to retail clients. Part 7.7 therefore achieves one of the main policy aims of the FSR Bill, to ensure that consumers of financial products and services receive adequate information about those products and services.

12.2 Part 7.7 applies to both financial services licensees and authorised representatives. Where a licensee is acting as an authorised representative for another licensee in respect of the financial service provided to the client, the first-mentioned licensee is treated as an authorised representative for the purposes of the provisions in Part 7.7 (see proposed section 940A).

12.3 The Part does take into account, in proposed section 940B, that there may not be a reasonable opportunity to give a document, information or statement as required by Part 7.7. In that situation, a failure to provide the document or other information is not a contravention of the provisions. However, the providing entity cannot escape the obligation to provide disclosure merely by failing to make reasonable inquiries of the client to obtain the latter's address or fax number, where the client has not provided these.

12.4 Of course, to be effective disclosure, the client must actually receive the prescribed disclosure documents, information or statements. Proposed section 940C therefore outlines the means by which providing entities may provide the relevant information to clients. Unless the requirements of the provision are satisfied, the giving of the document, information or statement will not be effective.

Financial services guide

General requirement to provide FSG

12.5 As a general rule, financial services licensees and authorised representatives who provide financial services to retail clients are required to give those retail clients a Financial Services Guide (FSG) (see proposed sections 941A and 941B).

12.6 The purpose of the FSG is to ensure that retail clients receive key information about the type of services being offered by a financial providing entity. The provisions relating to FSGs are based on requirements applying under both the existing Corporations Law and life insurance regimes. However, the FSR Bill extends these obligations to financial services offered in respect of all financial products regulated by the Bill.

Exceptions to requirement to provide an FSG

12.7 Proposed section 941C sets out five exceptions to the general requirement that a retail client must be given an FSG. These exceptions are:

- where the client has already received an FSG that contains all of the prescribed information;

- where the providing entity is a product issuer and, in providing the service, is doing no more than dealing in its own products. The basis for this exception is that the information relevant to the client that would otherwise be disclosed in the FSG will be contained in the Product Disclosure Statement (PDS) provided by the product issuer under proposed Division 2 of Part 7.9;

  – however, where an authorised representative of a product issuer or a third party financial services licensee or its authorised representatives deals in the financial product, an FSG must be provided to the client;

  – also, where a product issuer provides other services such as advice, an FSG will be required;

  – the exception also does not apply in relation to a dealing in derivatives, as a licensee who effects a trade on a financial market on behalf of a client will be regarded as the product issuer, and will therefore have to provide a PDS. In addition to their role as product issuer, such licensees are also performing intermediary services which should be subject to disclosure under the FSG;

- where the providing entity is the responsible entity of a managed investment scheme and the financial service provided is merely the operation by the responsible entity of that scheme. The basis for this exception is that the information relevant to the client that would otherwise be in the FSG, will be contained in the PDS provided for each financial product offered as part of the scheme.

  – Where a responsible entity deals in its own products, the product issuer exemption discussed above would apply.

  – And where a responsible entity provides other services, such as advice, an FSG would be required:

- where general advice is provided in a public forum. However, the providing entity must provide retail clients with the name of the provider and contact details, and information about any associations or relationships between the providing entity and the issuers of any financial products, where those associations or relationships are capable of influencing the providing entity in providing the general advice. Where the providing entity is an authorised representative, details about the licensee for whom they act must also be provided;

- where the financial service is a dealing in or otherwise relates to a basic deposit product or a facility for making non-cash payments that is related to a basic deposit product. This exception recognises that consumers generally understand the nature of basic deposit products and therefore do not require extensive disclosure in relation to such financial products. However, if the exception applies, the client must be given the information that would normally be included in an FSG under proposed paragraphs 942B(2)(a) and (h), or paragraphs 942C(2)(a) and (i), as the case requires;

- where the regulations specify other exemptions. However, no exemptions by way of regulations are contemplated at this stage.

Timing of giving of FSG

12.8 As a general rule, the FSG must be given to the retail client as soon as practicable after it becomes apparent to the providing entity that the financial service will be provided to the client. In any event, the FSG must be given to the client before the financial service is provided (see proposed section 941D).

12.9 It is anticipated that the FSG would in most instances be given to the retail client at first contact with that client. For example, an FSG should be given to a client:

- when the client attends a first meeting with the providing entity; or
- where contact is by way of phone, fax or other electronic means - the FSG should be faxed, sent by electronic mail or posted to the client as soon as possible after first contact is made.

Exception in time critical cases

12.10 Where a client instructs the providing entity to provide a financial service immediately and it is not practicable to give the FSG to the client before the service is provided, the client must be given the FSG within five days. In addition, before the service is provided the providing entity must give the client an oral statement containing FSG information that is relevant to the service the client has requested. The oral statement must include information about remuneration or other benefits and information about any associations or relationships with product issuers capable of creating conflicts of interest (proposed section 941D).

Information must be up-to-date

12.11 Retail clients must be provided with an up-to-date FSG before a financial service is provided (proposed sections 941E and 941F, however, there is no liability in relation to a contravention of proposed section 941E). Where a series of financial services are provided to a client, an FSG will only need to be given at the outset unless the information in the original FSG ceases to be accurate in some material respect. In these circumstances the client must be provided with an updated FSG or with a Supplementary Financial Services Guide (SFSG) before a service is provided.

Content and authorisation of FSG

12.12 The cover or front of each FSG must include the title ‘Financial Services Guide’; however this may be abbreviated to ‘FSG’ in any other part of the document (proposed section 942A).

FSG given by financial services licensee - main content requirements

12.13 The content of the FSG will differ depending on whether the providing entity is a financial services licensee or an authorised representative (see proposed sections 942B and 942C respectively). The differences stem from the requirement for authorised representatives to refer in the FSG to the existence of the licensee.

12.14 The content requirements have been formulated in such a way as to ensure that consumers receive key information required to make informed decisions about whether to acquire a financial service that is offered, while at the same time providing flexibility for industry in determining the level of information that should be included.

12.15 Proposed subsections 942B(3) and 942C(3) provide that the level of information required is that which a person would reasonably require for the purpose of making a decision whether to acquire financial services as a retail client.

12.16 Under proposed section 942B, the FSG must contain the following information where a financial services licensee is the providing entity:

- the name and contact details of the providing entity;
- any special instructions about how the client may provide instructions to the providing entity;
- information on the kinds of financial services offered by the providing entity, including the range of financial products to which those services relate;
- information about for whom the licensee acts when providing financial services. It is anticipated that this information would be most relevant where the providing entity acts on behalf of the client. This would be particularly relevant where the providing entity under proposed section 923B was authorised to use the term 'insurance broker'. In these circumstances, in addition to informing the client that the licensee acts on their behalf, it is expected that the FSG would include an explanation of what acting on behalf of a client means and how this differs from the relationship the client would have with a licensee who did not act on the client's behalf;
- information about the remuneration, commission and benefits received by the providing entity, a related body corporate, a director or employee of the providing entity or related body corporate, an associate of any of these or any other person prescribed by the regulations for the purposes of this provision. The purpose of disclosure of commissions, fees and charges in the FSG is so that the client will understand how they will be paying for the financial service they are being offered (as distinct from payments for a specific financial product). Therefore, the client must be informed if they have to pay an up front fee for the financial service and how much that fee will be, or whether the provider will be remunerated for their services by way of salary, or by commission resulting from the sale of specific financial products, or by a combination of means. The regulations may also require the providing entity to provide the client with more detailed information on remuneration;
- information about any associations or relationships between the providing entity (or any related body corporate) and the issuer of a financial product that might reasonably be expected to influence the providing entity in providing financial services. The purpose of this requirement is to ensure that the client is alerted to potential influence on the service provided, for example, cross-ownership links or indebtedness of providing entity to product issuers;
- where a providing entity provides execution-related telephone advice (as defined in proposed section 946B) and does not usually provide clients with a record of that advice unless requested, the FSG must include a statement alerting the client to their right to request a record of that advice and how they make such a request;
- information about the internal and external dispute resolution procedures to which the client has access;
- where a providing entity acts under a binder, they will be required to disclose to the client the services provided under the binder and the significance of those services being provided under a binder;

- where a providing entity is a participant in a licensed financial market or a licensed clearing and settlement facility, they must include in the FSG a statement to that effect;

- any other statements or information prescribed by the regulations.

12.17 A flexible regulation-making power is included to both disapply disclosure of certain information in specified circumstances and also to prescribe in more detail the information required under one of the above headings in particular or general situations.

12.18 The FSG must include the date of preparation, and may also contain other information in addition to that required to be included.

FSG given by authorised representative — main content requirements

12.19 The content requirements for an FSG given by an authorised representative are based on those requirements for an FSG provided by a licensee, but expanded to require information about the licensee(s) who have authorised the representative and information, where relevant, about the employer of the authorised representative (proposed section 942C). A flexible regulation making power is also included in proposed section 942C.

12.20 Again, the FSG must include the date of preparation, and may also contain other information in addition to that required to be included.

Financial Services Guide may consist of two or more documents

12.21 To provide flexibility in how FSGs are prepared and presented to clients, proposed section 942D provides that an FSG may be made up of two or more documents which, when taken together, contain all the required information. These documents must all be given to the client at the same time. Also, each document must include on its cover or front, a statement that the document is part of an FSG and that identifies the other related documents.

12.22 However, to ensure that FSGs are comparable among different providing entities, a regulation-making power is provided to enable additional requirements to be imposed where an FSG is comprised of multiple documents.

12.23 Proposed section 924E prohibits the provision to a client of an FSG that has been altered after the preparation date noted in the FSG, but before giving it to the client — unless the alteration was made by or with the authority of the financial services licensee who provided the FSG to the client, or the licensee(s) who authorised the distribution of the FSG via authorised representatives. Where the alteration is material, the date on the FSG must be changed to reflect the date of alteration.

Supplementary Financial Services Guides (SFSG)

12.24 A SFSG allows a person who has prepared an FSG to update it, or to correct an omission or a misleading or deceptive statement in the original FSG (proposed section 943A). An authorised representative may only give a person such a document where this is authorised by the licensee.

12.25 Proposed section 943B requires such a document to bear the title ‘Supplementary Financial Services Guide’ on its cover or on or near the front of it. In other parts of the document, this may be abbreviated to ‘SFSG’.

12.26 The SFSG must also state that it is an SFSG, identify the FSG that it supplements and include a statement that it is to be read with that FSG and any other SFSGs. The SFSG must include a preparation date. Where it is to be distributed by an authorised representative, it must contain a statement that this distribution is authorised by the licensee (proposed section 943C).

12.27 Proposed section 943D provides for the effective incorporation of the information in the SFSG into the original FSG.

12.28 Proposed section 943E makes it clear that an SFSG may be used to update an FSG, where a new FSG may otherwise be required to be given to the client. The provision requires that an FSG have been provided to the client at some point.

12.29 Proposed section 943F mirrors section 942E (in relation to the alteration of FSGs) in the context of an SFSG.

Additional requirements for personal advice provided to a retail client

12.30 These provisions only apply where personal advice (as defined in proposed section 766B(3)) is provided to a retail client. The provisions apply both where the advice is provided by a financial services licensee and where the advice is provided by an authorised representative (proposed section 944A).

Requirement to have a reasonable basis for the advice

12.31 Under proposed section 945A, where personal advice is provided to a retail client, the providing entity must have a reasonable basis for that advice. The providing entity is required to ascertain the client's objectives and their financial situation and needs, investigate and consider the options available to the client, and base the advice on that consideration and investigation.

12.32 It is an offence to contravene this provision. However, where an authorised representative contravenes this provision, they have a defence if they acted in reasonable reliance on information given to them by one of their licensees. Subsection (3) then places an obligation (with an appropriate offence) on a licensee to take reasonable steps to ensure that authorised representatives comply with requirement to have a reasonable basis for advice.

12.33 The level of inquiry and analysis required will vary from situation to situation and will depend on the advice requested by the client. The providing entity need only obtain and analyse sufficient information about the client to provide the advice requested or proffered. So, for example, a comprehensive analysis of the client's full financial position may not be necessary where the client has sought personal advice on a specific product.

12.34 It should be noted that there is no obligation on a providing entity to provide personal advice. A providing entity from whom personal advice is sought may decline to provide the advice (and of course, where the providing entity's licence or authorisation does not cover the provision of advice, would be obliged to decline to give the advice).

Obligation to warn client if advice based on incomplete or inaccurate information

12.35 Where a providing entity gives a client personal advice based on information about the client that is incomplete or inaccurate, the providing entity must warn the client about the limitations of the advice and that the client should consider the appropriateness of the advice before acting on it (proposed section 945B). It is anticipated that advice based on incomplete or inaccurate

information may be provided in circumstances where the retail client is unwilling to provide information requested by the providing entity but still seeks the advice.

12.36 The warning must be provided to the client at the same time as the advice is provided and by the same means as the advice is given.

12.37 In relation to contraventions of proposed section 945B, it would be inappropriate to give authorised representatives a defence, and place a corresponding obligation on licensees, as the offence is dependent on the providing entity's actual state of mind (see approach above in relation to proposed section 945A, for example). The authorised representative's view of whether the information they had was incomplete or inaccurate would be affected by their individual discussions and interaction with their client. Simply requiring an authorised representative to comply with instructions or directions supplied by their licensee would not necessarily be adequate to ensure compliance with this provision.

Requirement for a Statement of Advice to be given

12.38 Where a retail client is given personal advice, the providing entity must provide the client with a Statement of Advice (SoA). The SoA may be the means by which advice is given, or a separate record of the advice (proposed section 946A).

Exception for execution-related telephone advice

12.39 Proposed section 946B sets out two exceptions to the requirement to give a SoA. The first exception applies where the advice is 'execution-related telephone advice'. This is defined as advice given by telephone, relating to financial products that are able to be traded on a licensed financial market that is given by the providing entity as an integral part of the execution or transfer of, or order for, those financial products and is advice for which no fee is charged in addition to the commission for the execution of the transfer or order.

12.40 This exception is based on the existing Corporations Law regime exception for execution-related telephone advice provided in relation to securities. This exception has been extended to cover all financial products that are able to be traded on a licensed financial market. Where this exception applies, the providing entity does not have to give the client a SoA if the client agrees to this, and the FSG given to the client discloses that the client may request a record of advice, and the providing entity maintains a record of the advice in accordance with the regulations. It is proposed that the regulations will require a record of advice to be kept or a written summary of recommendations made and the basis of those recommendations.

12.41 While in these circumstances the providing entity is not required to provide a SoA, it must — at the time the advice is given — inform the client of any commission, fee, benefit or advantage that the providing entity or an associate will receive in connection with the advice, any other interests of the providing entity or an associate, and any associations or relationships between the providing entity or an associate and a product issuer that might reasonably be expected or be capable of influencing the providing entity in providing the advice.

12.42 The providing entity must comply with a request made by a client for a record of advice as described in the FSG. Failure to comply with this provision is an offence.

12.43 The objective of these provisions is to provide the client with the consumer protections afforded by the SoA and related disclosure requirements, while at the same time ensuring that the giving of telephone-executed advice and the ability of the client to act quickly on that advice is not unduly hindered.

Exception for basic deposit products

12.44 The second exception to the requirement to provide a SoA applies to personal advice provided in relation to basic deposit products or a facility for making non-cash payments that relates to a basic deposit product. Again, however, the providing entity must — at the time the advice is given — inform the client of any commission, fee, benefit or advantage that the providing entity or an associate will receive in connection with the advice, any other interests of the providing entity or an associate, and any associations or relationships between the providing entity or an associate and a product issuer that might reasonably be expected or be capable of influencing the providing entity in providing the advice.

Timing of giving Statement of Advice

General rule

12.45 As a general rule, if the SoA is given separately to the advice, the SoA must be given to the client when the advice is provided, or as soon as practicable after the giving of advice, but in any case before the providing entity provides the client with any further service arising out of the advice (see proposed section 946C). For example, where the advice recommends the purchase of a financial product, the provider of the advice must give the client the SoA before selling the client the product.

12.46 If the SoA is not given to the client when the advice is provided, the providing entity must inform the client orally of:

- any commission, fee, benefit or advantage, which the providing entity (or a related body corporate, a director or employee, or an associate) will receive in connection with the advice;
- any other interests of the providing entity or an associate, and any associations or relationships between the providing entity, or an associate, and a product issuer that might reasonably be expected or be capable of influencing the providing entity in providing the advice; and
- if the advice includes a recommendation to replace existing financial products, details of any charges the client will incur in replacing the business, any pecuniary or other benefits that the client may lose as a result of replacing business, and any other significant consequences for the client of replacing the business.

Exception in time critical cases

12.47 An exception to the general timing rule is provided in time critical situations (proposed subsection 946C(3)). Where a client instructs the providing entity to immediately provide a financial service arising out of the advice and it is not reasonably practicable for the providing entity to give the SoA before the service is provided, the SoA must be provided:

- within five days after providing the financial service; or
- where the service relates to a financial product with a cooling-off period (proposed section 1019B), before the commencement of the cooling-off period.

Content of Statement of Advice

Title of Statement of Advice

12.48 The cover or front of each SoA must include the title 'Statement of Advice'. In other parts of the document the abbreviation 'SoA' may be used (proposed section 947A).

Statement of Advice given by financial services licensee - main content requirements

12.49 The content of the SoA will differ depending on whether the providing entity is a licensee or an authorised representative. The differences derive from the requirement for authorised representatives to refer in the SoA to the existence of the licensee and, where relevant, an employer (see proposed sections 947B and 947C).

12.50 The content requirements are intended to ensure that consumers receive information necessary to make informed decisions about whether to act on the advice, while at the same time allowing industry some flexibility in determining the level of information that should be included.

12.51 Subsections 947B(3) and 947C(3) provide that the level of detail of information required is that which a person would reasonably require for the purpose of making a decision whether to act on the advice provided.

12.52 Where the licensee is the providing entity, the SoA must contain the following statements and information:

- a statement setting out the advice;
- an explanation of the basis on which the advice is given. This should canvas the consideration given to the client's objectives, financial situation and needs and how the advice will address those objectives, financial situation and needs. It should illustrate how the recommendation made to the client addresses the request for advice originally made by the client, taking account of subsequent investigations and considerations on the part of the providing entity;
- name and contact details of the providing entity;
- information about any remuneration (including commission) or any other benefits that the providing entity, a related body corporate, a director or employer, or an associate will receive in connection with the advice that might reasonably be expected to be capable of influencing the providing entity in providing the advice;
- details of any benefit or advantage (whether or not pecuniary) which may reasonably be expected to influence the financial providing entity in giving the advice must be provided. Wherever possible, disclosure should be in dollar amounts. Where this is not possible, percentage amounts or written description must be provided. Benefits disclosed must include commission, soft dollar remuneration, sales quotas and volume bonuses;
- information about any other interests, whether pecuniary or not, of the providing entity or an associate that might reasonably be expected to be capable of influencing the providing entity in providing the advice;
- information about any association or relationships between the providing entity or an associate and product issuers that might reasonably be expected to be capable of influencing the providing entity in providing the advice;

- where applicable, the warning required in proposed section 945B that the advice provided may be based on incomplete or inaccurate information and that the client should consider the appropriateness of the advice before acting on it;

- other information required by regulations.

12.53 A flexible regulation-making power is included to both disapply disclosure of certain information in specified circumstances and also to prescribe in more detail the information required under one of the above headings in particular or general situations.

12.54 In addition to information required to be included in the SoA, the SoA may also contain other information.

Statement of Advice given by authorised representative - main content requirements

12.55 The content requirements for a SoA given by an authorised representative mirror those requirements where the SoA is given by a licensee, but expanded to require information about the licensee(s) who have authorised the representative and, where relevant, information about the employer of an authorised representative (proposed section 947C).

12.56 The employer of an authorised representative has been included in these provisions to ensure that, for example, commission splitting between a natural person authorised representative and the corporate authorised representative that employs the natural person are disclosed.

Additional requirements when advice recommends replacement of one product with another

12.57 Where a client is advised to replace an existing financial product, specific disclosures are required in the SoA to enable the client to assess the cost of replacing a product and the potential financial loss or loss of benefits that may result (proposed section 947D).

12.58 The objective of this requirement is to alert clients to the disadvantages as well as the advantages of acting on advice to replace an existing product. It is anticipated that this requirement will limit the potential for twisting and churning.

Qualified privilege if providing entity complies with the Division

12.59 Proposed section 948A is based on section 853 of the existing Corporations Law, and provides that a providing entity has qualified privilege in respect of a statement made to a client in connection with providing personal advice, if the providing entity complies with the requirements relating to the provision of personal advice.

Other disclosure requirements

General advice warning

12.60 Where general advice is provided to a retail client, no SoA is required. However, at the time of giving the general advice and by the same means as the general advice is given, the providing entity must warn the client that the advice has been prepared without taking account of the client's objectives, situation and needs and the client should therefore consider the appropriateness of the advice to their situation before acting on the advice (proposed section 949A).

12.61 Warnings must accompany all general advice regardless of the medium used to provide that advice. For contraventions of this provision, the general approach described below has been taken, so that authorised representatives have a defence available to them with a corresponding duty on licensees to ensure that authorised representatives comply.

Regulations may impose disclosure requirements in certain situations

12.62 A regulation making power has been included at proposed section 949B to allow the imposition of disclosure requirements or additional disclosure requirements in the following situations:

- where a financial service related to an insurance product is provided to a retail client under a binder;
- where a financial services licensee or authorised representative arranges for a person's instructions to be carried out outside Australia. It is proposed that regulations would be made requiring, where relevant, disclosure to the client that their instructions are to be carried out through an overseas financial market or clearing and settlement facility and the ramifications arising from this;
- where the person provides a financial service as a member of a declared professional body (DPB);
- where persons are exempt from the Financial Services Licensee provisions.

12.63 The approach to contraventions of this provision is in accordance with the general approach outlined below. The offence for not providing the information required by the regulations is contained in the Act, rather than the regulations themselves, so that a penalty which includes a period of imprisonment can be applied. This would not be possible for regulations created by offences where it is proposed that the maximum penalty will be 50 penalty units. This approach is a recognition that the disclosure obligations in this provision could be of real significance to a client.

Obligations of members of declared professional bodies who provide advice

12.64 Certain obligations and requirements apply where a member of a DPB provides personal advice to a retail client.

12.65 The providing entity (that is, the member) may only provide advice that is appropriate when assessed in light of the client's objectives, financial situation and needs (see proposed section 950B).

12.66 Proposed section 950C imposes an obligation on the providing entity to inform the client, where appropriate, that the advice provided may be based on incomplete or inaccurate information and that the client should consider the appropriateness of the advice before acting on it. The warning must be given to the client at or before the giving of the relevant advice.

12.67 Proposed section 950D requires the providing entity to disclose details of commissions, fees, benefits and interests received by the entity in connection with the provision of the advice, and that might reasonably be expected to influence the entity in the provision of the advice. The disclosure requirements extends to commissions and other benefits given to associates of the providing entity, and to the DPB and to any associates of the DPB.

12.68 The level of detail required of this information is such that a person would reasonably need to decide whether to act on the advice (proposed subsection 950D(2). The regulations may disapply any of the requirements to disclose information, and may require a more detailed statement of the information.

12.69 Where a client is advised to replace an existing financial product, specific disclosures are required in the SoA to enable the client to assess the cost of replacing a product and the potential financial loss or loss of benefits that may result (proposed section 950E).

Part cannot be contracted out of

12.70 Proposed section 951A provides that a condition of a contract for the acquisition of a financial product or the provision of a financial service is void if it provides that a party to the contract is required or bound to waive compliance with any requirement of Part 7.7 or taken to have notice of any contact, document or matter not specifically referred to in an FSG, SoA or other document given to the party.

General approach to criminal liability

12.71 Criminal liability for contraventions of those provisions of Part 7.7 that relate to the giving of documents or statements to clients by a licensee, authorised representative of a licensee or member of a DPB, is dealt with in Division 7 of Part 7.7. However, Divisions 3 to 5 of Part 7.7 also contain a number of other offences created by the operations of subsection 1311(1); these are indicated by notes under the relevant provisions.

Liability of authorised representatives

12.72 There are a number of provisions in Part 7.7 that relate to the criminal liability of authorised representatives and licensees for failures by authorised representatives to comply with Part 7.7. These rules are designed to ensure that in situations where there has been a contravention of a requirement of Part 7.7, criminal liability falls appropriately on either the licensee or the authorised representative. They ensure that while licensees are generally liable for the ensuring that their representatives comply with the law (in accordance with their obligations in proposed paragraph 912A(c)) they are not made liable for individual actions of authorised representatives, in situations where it is appropriate that the authorised representative is held liable.

12.73 However, where authorised representatives have been given directions or instructions from a licensee and reasonably relies on them, they are generally provided with a defence, as in these situations it is appropriate that the licensee is liable for a failure to provide adequate instructions or directions to their authorised representatives.

12.74 This is achieved in a number of provisions by initially stating that the providing entity that actually contravenes the provision (including an authorised representative) is liable. However, a defence is then provided for an authorised representative who has acted in reasonable reliance on information given to them by one of their licensees. There is then an obligation on the licensee to take reasonable steps to ensure that authorised representatives comply with the particular requirement. It is intended that a licensee will contravene this obligations where they take no steps, as well as where they provide information or instructions, but these are not sufficient to ensure that the authorised representative in complying with them does, in fact, comply with the requirements of Part 7.7.

12.75 This approach recognises that authorised representatives are not subject to the day to day supervision of licensees in the same way that, for example, employees are. It is intended to promote the role of authorised representatives by ensuring that licensees do not face an unnecessarily burdensome liability for their actions (it thus provides an incentive for licensees to authorise representatives), while giving authorised representatives a safe harbour where they act in accordance with directions and information given to them by licensees. It also recognisees the obligation on licensees to properly supervise authorised representatives.

Liability of members of declared professional bodies

12.76 The liability of members of DPBs is different from that of authorised representatives. Generally, members of DPBs are liable for their actions in the same way as licensees, that is, they are responsible for ensuring that their actions comply with proposed Chapter 7 and they do not have the defences available that authorised representatives have.

Liability for disclosure document and statements

12.77 Proposed Division 7 refers to documents or statements that are required to be given by proposed Part 7.7 as 'disclosure documents or statements'. These are defined in proposed section 952B and includes an FSG, an SFSG, a SoA and a range of other statements that are either given instead of these other documents or are required to be given by a member of a DPB.

12.78 Liability for FSGs or SFSGs is dealt with differently from other disclosure documents or statements, although these documents can be prepared by the licensee, authorised representative or a combination of both, they must be authorised by all licensees of an authorised representative. Proposed section 952K makes it an offence for an unauthorised representative to give out an FSG or SFSG where it has not been authorised by their licensee. Proposed section 952M makes it an offence for a person to give someone an FSG or SFSG which has been altered otherwise than in accordance with the licensee's authority. Proposed section 952H provides a general obligation on licensees to take reasonable steps to ensure that authorised representatives comply with the requirements of Part 7.7 relating to the provision of disclosure documents or statements. This is consistent with the approach to liability of licensees for their authorised representatives discussed above.

Failure to provide disclosure document or statement

12.79 It will be an offence to fail to give a disclosure document or statement where required by a provision of Part 7.7 (proposed section 952C). It should be noted that this requires that the statement is given at the required time and in the required manner (proposed paragraph 952C(1)(b)). Proposed section 940C details the manner in which a document or statement may be given but is also subject to proposed section 940B which deals with situations in which there has been no reasonable opportunity to provide the document or statement. For authorised representatives, this provision provides a defence for following directions or information provided by a licensee that follows the general approach outlined above.

12.80 In addition to an offence requiring fault elements, a strict liability offence is also provided. This provides greater enforcement flexibility and allows for straightforward and effective enforcement of technical contraventions of the provision relating to, for example, not giving a statement in the required manner or at exactly the right time. Therefore, the strict liability offence has a lower pecuniary-only penalty attached to it.

Providing defective disclosure document or statement

12.81 There are a number of offences related to providing a disclosure document or statement that does not contain the information required or where that information is in some way inaccurate.

When a disclosure document or statement is defective

12.82 For these provisions the term 'defective' is defined in proposed section 952B. Generally, a disclosure document or statement will be defective if it contains a misleading or deceptive statement or does not contain the information required by Part 7.7 and the statement or omission is or would be materially adverse from the point of view of a reasonable person considering whether to act in reliance on the advice.

12.83 This ensures that while there is criminal liability for the making of statements that may be of detriment to clients, the requirement is not overly onerous and may not apply to minor or technical faults or in relation to statements or omissions that could not result in detriment to the person relying on it.

When a disclosure document or statement is 'given'

12.84 For the purposes of these provisions, the 'giving' of a disclosure document or statement means giving it either in a situation where Part 7.7 requires one to be given or the giving of an FSG or SFSG in other situations where the person to whom it is given may rely on the information contained in it (see proposed subparagraph 952D(1)(a)(ii) for an example of this). As FSGs and SFSGs are specially prepared documents, it is appropriate to ensure that the same liability regime applies to them in all situations where they are provided to clients. For other disclosure documents or statements that might be given in situations where they are not required to be given by Part 7.7, other provisions such as the general prohibition on false and misleading statements in proposed section 1041E could apply.

12.85 While the method by which something must be given is set out in proposed section 940C, the offences related to provision of defective documents or statements cover the 'giving' of them by any means, not just those described in that provision.

Providing a disclosure document or statement knowing that it is defective

12.86 Proposed section 952D makes it an offence to give a disclosure document or statement knowing that it is defective. No defence is provided for authorised representatives as the provision requires actual knowledge that the statement or document is defective.

Providing a disclosure document or statement that is defective (whether known to be defective or not)

12.87 Proposed section 952E deals with liability for the giving of a disclosure document or statement that is defective, regardless of whether it is actually known to be defective.

12.88 Licensees and members of DPBs are potentially liable for all disclosure documents or statements that they give. However, authorised representatives are only liable in situations where the disclosure document or statement is not an FSG or SFSG (these other statements are listed in proposed paragraph 952E(3)(a)). Authorised representatives are not liable for FSGs and SFSGs because these have to be authorised by the licensee who is then responsible for their content. Whereas the other disclosure documents or statements are ones which they may prepare and give themselves.

12.89 Where a person is potentially liable, they will have a defence of having taken 'reasonable steps' to ensure that the disclosure document or statement would not be defective' (for example, proposed subsection 952E(5)). This defence is in contrast to the current due diligence defence in section 731 of the Corporations Law and is intended to be less onerous than it.

12.90 It is necessary to apply strict liability to the element of the offence that the document or statement was defective. If this is not done then the Criminal Code default element of 'recklessness' could apply and potentially act as an alternative to the 'take reasonable steps' defence.

12.91 For statements for which authorised representatives could be liable under this provision, proposed subsection 952E(6) provides flexibility to the liability regime. It gives an authorised representative a defence where the defective document or statement was given to them by a licensee or was defective because of information (or an omission from such information) given to them by the licensee. This allows these particular documents or statements to be prepared by either the licensee or the authorised representative or a combination of both and ensures that liability for a defect falls appropriately on the responsible party.

Provision of information to an authorised representative by a licensee

12.92 Proposed sections 952F and 952G cover the situations where a licensee may provide to an authorised representative either a defective disclosure document or statement or information for inclusion in such a document or statement that makes it defective. In these situations the authorised representative would not be liable in relation to an FSG or SFSG (proposed section 952E does not make an authorised representative liable for a defective FSG or SFSG) and may not be liable for the defective document or statement in other cases, so it is necessary to provide appropriate offences in relation to the licensee.

12.93 Proposed section 952F will make it an offence for a licensee to:

- authorise the distribution of an FSG or SFSG or provide an authorised representative with another type of disclosure document or statement to distribute where the licensee knows that the disclosure document or statement is defective; or

- provide an authorised representative with information knowing that it will be included in a disclosure document or statement if:

  - the licensee knows that the information will make the disclosure document or statement defective; or

  - the licensee knows that the information is not all the relevant information (that is, it omits some matters) and the authorised representative may prepare the disclosure document or statement on the basis that it is all the information on that matter that it is required to contain.

12.94 Proposed section 952F is otherwise similar to proposed section 952D.

12.95 Proposed section 952G deals with the same situations as proposed section 952F but does so where the licensee did not necessarily know that the disclosure document or statement was defective or that the inclusion of the information provided would make it defective, but this was, nevertheless, the case. It has the same relationship to proposed section 952F as proposed 952E does to proposed 952D. A defence of 'reasonable steps' is provided as in proposed section 952E.

12.96 The provision (in proposed paragraph 952G(2)(b)) excludes situations where a disclosure document or statement is defective only because of information that relates to another licensee of

the authorised representative. This ensures that where an authorised representative has multiple licensees and, for example, there is information in an FSG that relates only to one of those licensees and that information is defective, other licensees are not liable for it even though they have authorised the FSG. They would, however, be liable under proposed section 952F if they had actual knowledge that it was defective.

When a person finds out that an FSG is defective

12.97 Proposed section 952L ensures that where either a licensee or an authorised representative becomes aware that an FSG or SFSG is defective, steps are taken to either rectify the defect or prevent the document from being given out. It will make it an offence for a licensee who becomes aware that an FSG or SFSG is defective to fail to give an authorised representative a direction to rectify the defect or stop giving out the FSG. It is an offence to contravene such a direction. It is also an offence for a representative who becomes aware that a section 853 FSG or SFSG is defective to fail to inform their licensee.

Formal Requirements

12.98 Proposed section 952I makes it an offence for a licensee to give out an FSG or SFSG themselves or authorise its distribution by an authorised representative where it does not comply with the formal requirements relating to FSGs and SFSGs (such as ensuring that 'FSG' is on the cover of the document or that the document is dated). The offence can only be committed by a licensee as they must authorise and are, therefore, responsible for the content of an FSG or SFSG.

12.99 Proposed section 952J similarly deals with formal requirements of a SoA. This offence is committed by the person who prepares the SoA (including an authorised representative).

12.100 Strict liability applies to the circumstance that the document does not comply with the relevant formal requirements. This is necessary to ensure the effective enforcement of contraventions of these provisions which carry only a low pecuniary penalty and are offences of a technical nature. Otherwise, the fault element of recklessness would apply to this circumstance. Strict liability does not apply to the actual giving or authorising of the statement as the application of the fault element of intention to this conduct would not be particularly difficult to show.

Civil liability

12.101 Subdivision B of Division 7 of Part 7.7 provides people with a civil action for loss or damage for contraventions of provisions of Part 7.7. Proposed section 953B lists the situations where such action may be taken. They include contraventions of certain provisions (such as failure to have a reasonable basis for advice), not providing a disclosure document or statement where required or providing a defective one.

12.102 For the purposes of civil liability, 'defective' is defined in proposed section 953A. It is similar to the definition for criminal liability but does not require the statement of omission to be materially adverse. The 'materially adverse' concept is not appropriate for civil liability, as a person must demonstrate that they have suffered loss or damage as a result of the defect. This in itself establishes that the defect was significant without any need for a requirement of 'materially adverse'.

12.103 Proposed subsection 953B(7) provides that for an action relating to a defective document or statement a person is not liable where they took 'reasonable steps' to ensure that the document or statement would not be defective. This is consistent with the approach taken for criminal liability.

12.104 Proposed subsections 953B(3) and (4) set out who is liable. Generally, the licensee is liable regardless of whether the contravention resulted from conduct of the licensee or an authorised representative. This ensures that clients will always have a licensee to take action against for loss or damage. The only exception is where a person altered an FSG or SFSG without authority from the relevant licensee. In that situation (beyond the control of the licensee) the person who made the alteration is liable. Where more than one licensee is potentially liable, proposed section 917C is used to determine which licensee or licensees jointly are liable.

12.105 In addition to the power to being able to recover loss or damage under these provisions, proposed section 953C also gives the court the power to make additional orders where it thinks these are necessary to do justice between the parties. These orders include declaring a contract void and any additional orders that are necessary or desirable because of that order. These additional orders can include but are not limited to an order for the return of money or payment of an amount of interest.

13

Other provisions relating to conduct etc

Preliminary

13.1 Proposed Part 7.8 contains provisions relating to the conduct of financial services licensees as well as miscellaneous provisions relating to other conduct connected with financial products and services.

13.2 Broadly it provides that licensees will be required:

- to establish and maintain a separate account in which to hold client (both retail and wholesale) funds;
- where they hold funds or assets on behalf of clients, to provide periodic statements to clients;
- to keep financial records that correctly record and explain the transactions and the financial position of the financial services business carried on by a licensee;
- to prepare profit and loss statements and balance sheets and lodge them with an auditor's report with ASIC;
- to give priority to clients' orders; and
- to disclose and obtain client consent when they will be acting on their own behalf in a transaction with a non-licensee.

13.3 In addition, a prohibition on unconscionable conduct in the provision of financial services will apply.

13.4 Proposed Part 7.8 will replace the following Parts of the existing Corporations Law:

- Part 7.5 (Dealers' Financial Statements and Audit);
- Part 7.6 (Money and Scrip of Dealers' Clients); and
- Section 1209 and Part 8.5 (Financial Statements and Audit).

13.5 It will also replace related concepts in the IABA (which will be repealed in its entirety).

Dealing with client money

13.6 Division 2 of proposed Part 7.8 sets out the obligations of licensees in relation to client money and loan money. It also deals with the powers of the court in relation to accounts containing client money and loan money.

Money other than loans

13.7 Licensees will be required to establish and maintain a separate account in which to hold client money.

13.8 'Client money' is defined as money paid by a client, by a person acting on behalf of a client or for the benefit of a client in connection with a financial service that has been provided, or that may or will be provided to a client, or a financial product held by the client (proposed subsection 981A(1)).

13.9 The following is not client money:

- money received as remuneration (proposed paragraph 981A(2)(a));
- money paid to reimburse a licensee for payments made to acquire a financial product or to discharge liabilities incurred by a licensee relating to the acquisition of a financial product (proposed paragraph 981A(2)(b));
- money paid to acquire a financial product issued or sold by the licensee (proposed paragraph 981A(2)(c)); or
- money paid by way of a loan (proposed paragraph 981A(2)(d)).

13.10 Proposed subsection 981A(4) will enable regulations to be made that exempt money paid in specified circumstances from requirements relating to client money or apply these requirements as if certain provisions were omitted, modified or varied.

13.11 Accounts established to hold client money must be with an Australian ADI or such other account as prescribed by regulation and must be designated as an account for this purpose. Only client money, interest on client money and proceeds from the investment of client money may be paid into accounts. Money must be paid into accounts on either the day it is received by the licensee or the next business day (proposed subsection 981B(1)). Additional requirements in relation to accounts may be imposed by regulation (proposed paragraph 981B(1)(c)) or as conditions attached to the licence of a financial services provider. For example, in certain circumstances the regulations or licence conditions could require that the account be a trust account.

13.12 Proposed section 981C will enable regulations to be made dealing with the circumstances in which payments may be made into or out of accounts, minimum balances to be maintained in accounts; how interest on accounts is to be dealt with; and how proceeds from the investment of client money are dealt with. These regulations will enable provisions currently contained in IABA relating to the circumstances in which insurance brokers can invest money held in broker accounts to be transferred to the new regime.

13.13 Special provisions will apply to client money relating to derivatives. These will enable client money to be used to meet obligations incurred by the licensee in connection with dealings in derivatives on behalf of the licensee, including dealings on behalf of people other than the client (proposed section 981D).

13.14 The following provisions also relate to the holding of client money by licensees:

- protection of client money from attachment (proposed section 981E);
- a power to make regulations dealing with how client money is to be dealt with if a licensee ceases to be licensed (proposed subsection 981F); and
- no liability for an Australian ADI or other institution with which an account is held merely because of a licensee's contravention of these requirements (proposed subsection 981G).

Loan Money

13.15 Licensees will be required to ensure that loan money received from clients in connection with the activities authorised by a licensee's licence is paid into a separate designated account with an Australian ADI. This must be done on either the day the loan money is received by the licensee or the next business day (proposed section 982B).

13.16 Licensees must to provide clients with a statement setting out the terms and conditions on which the loan is made as well as the purpose for which the money will be used. Licensees will be unable to withdraw loan money from designated accounts before receiving a written acknowledgment from the client that the client has received such a statement (proposed section 982C).

13.17 Licensees may only use loan money in accordance with the statement provided by the licensee to the client or for another purpose subsequently agreed in writing between the licensee and the client (proposed section 982D).

Powers of Court

13.18 Proposed sections 983A to 983E set out the orders that a court can make in relation to accounts established to hold client money and loan money. These provisions are based on existing Corporations Law sections 874 to 878 and 1224 to 1227. They will enable a court to make a number of orders in relation to accounts, including orders to freeze accounts and orders relating to the payment of money from accounts.

Dealing with other property of clients

13.19 Division 3 of Part 7.8 of the proposed Bill sets out the obligations of financial services licensees where they are given client property (other than money). These provisions are based on sections 873 and 1214 and subsection 1209(6) of the existing Corporations Law.

13.20 Licensees will be accountable for client property given to them in connection with the provision of a financial service to a client or a financial product held by a client (proposed section 984A).

13.21 Proposed subsection 984A(2) will enable regulations to be made that exempt property given in specified circumstances from the requirements of Division 3 or that apply Division 3 to property given in specified circumstances as if specified provisions were omitted, modified or varied as specified in the regulations. Regulations may also place conditions on exemptions and provide for the consequences of a contravention of a condition (proposed subsection 984A(3).

13.22 Licensees will be required to ensure that client property is only dealt with in accordance with the terms and conditions on which the property was given to the licensee and any subsequent instructions from the client (proposed paragraph 984B(1)(b)).

13.23 Special provisions will apply to property relating to derivatives. Following the approach adopted in proposed section 981D, these provisions will enable client property to be used to meet obligations incurred by the licensee in connection with dealings in derivatives on behalf of the licensee including dealings on behalf of people other than the client (proposed subsection 984B(2)).

Special provisions relating to insurance

13.24 Division 4 of proposed Part 7.8 contains special provisions relating to contracts of insurance. These provisions will carry across the effect of the current section 14 of the IABA in which the insurer rather than the insurer bears the risk of funds held by an insurance broker.

13.25 Proposed section 985B provides that the payment of funds by an insured to a financial services licensee who is not an insurer will constitute a discharge of the liability of the insured to the insurer. However payment of funds by an insurer to a licensee of money payable to an insured will not discharge the liability of the insurer to the insured.

13.26 Proposed section 985C will enable regulations to be made governing the duties of insurance brokers in relation to insurance premiums. These regulations will enable the effect of the current section 27 of the IABA to be carried across to the new regime.

Reporting to clients where money or property is held

13.27 Division 5 of proposed Part 7.8 of the Bill deals with the obligation of financial services licensees to provide periodic statements to clients in relation to loan money or where funds or other property is held on behalf of clients:

- proposed section 986A will enable regulations to be made that impose additional general reporting requirements on licensees in relation to client funds, loan money or other property;
- proposed section 986B will enable regulations to be made dealing with reporting in relation to dealings in derivatives by financial services licensees on behalf of other people;

Financial records, statements and audit

13.28 Division 6 of proposed Part 7.8 applies to financial services businesses carried on by financial services licensees (proposed subsection 987A(1)). The obligations imposed on corporate licensees by Division 6 are in addition to those imposed on companies by Chapter 2M of the proposed Corporations Act (proposed subsection 987A(2)).

13.29 Proposed subsection 987B(1) enables ASIC to exempt particular APRA regulated bodies from the requirements of Division 6, or to declare that Division 6 applies to particular bodies as if specified provisions were omitted, modified or varied as specified in the declaration. Exemptions may be unconditional or be subject to specified conditions. Bodies to which conditional exemptions apply must comply with relevant conditions. A court may order the body to comply with relevant conditions. However only ASIC may apply to the court for such an order (proposed subsection 987B(2)).

Financial records of financial services licensees

13.30 Each financial services licensee will be required to keep financial records that correctly record and explain the transactions and financial position of their financial services business (proposed section 988A).

13.31 The financial records of financial services licensees must also comply with the following requirements (based on sections 856 and 1213 of the existing Corporations Law):

- records must allow profit and loss statements and a balance sheet to be prepared and audited (proposed section 988B);
- records must be kept in the English language or in a manner that enables them to be readily converted into the English language (proposed section 988C);
- records must be sufficiently accessible within this jurisdiction (proposed section 988D); and
- records must be sufficiently detailed to show the particulars of all money received or paid by the licensee, all acquisitions and disposals of financial products made by the licensee, all income received and expenses paid by the licensee, all assets and liabilities of the licensee, all securities or managed investment products that are the property of the licensee or for which the licensee is accountable, and other such matters as are prescribed (proposed section 988E).

13.32 Proposed section 988F will enable regulations to be made that impose additional requirements in relation to the financial records of financial services licensees.

Financial statements of financial services licensees

13.33 Financial services licensees will be required to prepare profit and loss statements and balance sheets in respect of each financial year. This requirement is based on sections 860 and 1218 of the existing Corporations Law.

13.34 Licensees will be required to lodge profit and loss statements and balance sheets with ASIC (proposed section 989B). Proposed section 989C will enable regulations to specify requirements relating to the contents of profit and loss statements and balance sheets as well as applicable accounting standards (proposed section 989C).

13.35 Profit and loss statements and balance sheets will have to be lodged within two months after the end of the financial year (if the licensee is not a body corporate) or within three months after the end of the financial year (if the licensee is a body corporate). ASIC will be empowered to approve an extension of the deadline for lodging profit and loss statements and balance sheets on application of a financial services licensee and the licensee's auditor. Extensions may be granted subject to such conditions as ASIC imposes. Licensees must comply with any conditions that are imposed by ASIC (proposed section 989D).

Appointment of auditors

13.36 Provisions governing the appointment of auditors are set out in proposed subsections 990A to 990L. These provisions are based on sections 857 to 859, 861 and 863 as well as sections 1215 to 1217, 1219, 1220 and 1222 of the existing Corporations Law.

Other rules about conduct

Prohibition on unconscionable conduct

13.37 Proposed section 991A will prohibit a financial service licensee from engaging in unconscionable conduct in relation to the provision of a financial service. A person that suffers loss or damage as a consequence of such conduct will be able to recover the amount of the loss or damage through action against the licensee. It will be possible to begin such an action at any time within six years after the day on which the cause of the action arises.

Financial services licensee to give priority to clients' orders

13.38 As a general rule, financial services licensees will be required to give priority to client orders. This requirement is based on sections 844 and 1266 of the existing Corporations Law. These provisions have been integrated and extended so that they will apply to all financial products that are able to be traded on a financial market (proposed section 991B).

13.39 Proposed section 991C will enable regulations to be made that impose requirements on financial service licensees in relation to instructions to deal through licensed markets. These requirements may cover the sequence in which transactions are transmitted to a licensed market or another licensee who is a participant in a licensed market and the order in which dealings that have been effected on a licensed market are to be allocated to instructions. Proposed section 991C will also allow regulations to be made that prohibit the disclosure of instructions in specified circumstances. These regulations will carry over the effect of subsection 1266(4) of the existing Corporations Law, which relates to futures contracts.

13.40 Proposed section 991D will enable regulations to be made that impose requirements for the keeping of records relating to instructions received by financial services licensees to deal in financial products through licensed markets (whether inside or outside Australia) as well as the execution and transmission of such instructions. These regulations will carry over the effect of subsections 1266(7) and 1266(8) of the existing Corporations Law, which relate to futures contracts.

Own account dealings by licensees

13.41 As a general rule, proposed subsection 991E(1) will prohibit a financial services licensee (either personally or through an authorised representative) from knowingly entering into a financial product transaction on their own behalf that relates to a financial product that is able to be traded on a licensed market and that is with a person who is not a financial services licensee or an authorised representative (non-licensee). These transactions will only be permitted where the licensee has disclosed to the non-licensee that they will be acting on their own behalf and the non-licensee has consented to the transaction. If the licensee is acting through an authorised representative, the required disclosure must be provided by the representative.

13.42 Proposed subsection 991E(2) will permit regulations to specify how disclosure is to be made in these circumstances by the licensee or their representative and how consent is to be given by the non-licensee.

13.43 A financial services licensee that enters into an own account transaction may not charge the non-licensee brokerage, commission or a fee in respect of the transaction except as permitted by the regulations (proposed subsection 991E(3)).

13.44 The non-licensee may rescind a contract affecting a transaction where requirements relating to disclosure, consent and charging of fees have been contravened. This right will apply unless the relevant contract was for the purchase of financial products by the non-licensee and the non-licensee has subsequently disposed of the products. The right will be exercisable by providing a notice in writing to the licensee during the period of 14 days starting on either the date on which the contract was entered into or any later day specified in the regulations (proposed subsections 991E(4) and 991E(5)).

13.45 Proposed subsection 991E(7) will permit regulations to be made requiring records to be kept by licensees in respect of own account dealings.

Dealings involving employees of financial services licensees

13.46 Proposed section 991F carries over the effect of sections 845 and 1267 of the existing Corporations Law in relation to all financial products. Except as provided by the regulations, a financial services licensee will not be permitted to:

- jointly acquire a financial product with an employee; or
- give credit to an employee or a person they know is an associate of an employee if the credit is given for the purpose of enabling the person to acquire a financial product or if the person giving the credit knows or reasonably believes that the credit will be used for the purposes of acquiring a financial product.

13.47 Except as provided by the regulations, a person who is employed by a financial services licensee that is a participant in a licensed market and is employed in connection with the business of dealing in financial products must not acquire or agree to acquire financial products that are able to be traded on that market on their own behalf unless the licensee acts as the agent of the person in respect of the transaction.

Miscellaneous provisions

13.48 Proposed section 992A contains a general prohibition against the hawking of certain financial products. This prohibition will not apply to the offering of securities as these will be covered by the specific prohibition against securities hawking contained in section 736 of the proposed Corporations Act.

Enforcement

13.49 Most offences against provisions in Part 7.8 will be created through the operation of subsection 1311(1) of the proposed Corporations Act. Where offences are created in this manner, this is indicated by a note at the end of the provision that contains the rule.

Offences related to payment of money into accounts

13.50 Offences relating to contraventions of proposed subsections 981B(1), 982B(1) and proposed section 981C are contained in proposed Division 9 of Part 7.8. These provisions concern the payment of a client's money into certain accounts.

13.51 For each of these provisions, there is both an 'ordinary' offence which uses the default Criminal Code fault elements and a strict liability offence. It is intended that prosecutions for serious contraventions of these provisions will be brought under the ordinary offence.

13.52 However, as these offences contain a range of technical requirements including strict deadlines within which the money must be paid into the relevant account, a strict liability offence has been provided (with an appropriately lower penalty) to facilitate prosecutions for more minor contraventions of the provisions. This reflects the importance of the obligation on people to deal with a client's money in the specified manner.

14

Financial product disclosure

Preliminary

14.1 Proposed Part 7.9 of the draft Bill deals with disclosure throughout the life of a financial product from point of sale disclosure through to ongoing disclosure and periodic reporting requirements. Broadly it provides for:

- point of sale disclosure through the giving of a Product Disclosure Statement (PDS) (proposed Division 2);
- other obligations in relation to financial products (proposed Division 3) encompassing:
  - ongoing disclosures (proposed section 10177B);
  - periodic reporting requirements (proposed section 1017D);
  - handling money from applicants for financial products (proposed section 1017E);
  - confirmation of transactions in relation to financial products (proposed section 1017F); and
  - alternative dispute resolution mechanisms for product issuers (proposed section 1017G);
- requirements for advertising in relation to financial products (proposed Division 4); and
- cooling-off periods for certain financial products (proposed Division 5).

14.2 This disclosure regime will replace a range of existing disclosure regimes for financial products, some of which are legislative and some of which are self-regulatory:

- disclosure requirements for superannuation interests under the SIS Act and Regulations to the extent that they are dealt with under Part 7.9;
- disclosure requirements for retirement savings accounts under the RSA Act and Regulations;
- disclosure requirements for life insurance under Life Insurance Circular G.I.1;
- disclosure requirements for the products of deposit taking institutions under the Banking, Building Society and Credit Union codes of practice, and the EFT Code of Practice;
- disclosure obligations for interests in managed investment schemes under the fundraising provisions of the proposed Corporations Act; and

- disclosure obligations for futures under Chapter 8 of the proposed Corporations Act.

14.3 The Part 7.9 disclosure regime will also supplement, but not replace, disclosure requirements for insurance under the Insurance Contracts Act. Consequential amendments to the Insurance Contracts Act will be necessary to take account of the disclosure obligations in Part 7.9 and will be dealt with in subsequent legislation.

14.4 Part 7.9 will not replace the disclosure requirements for shares and debentures under Chapter 6D of the proposed Corporations Act. However, some consequential amendments are necessary to Chapter 6D to take account of the new disclosure regime and these are dealt with in Part 2 of Schedule 1.

Disclosure requirements for superannuation

14.5 Superannuation products (as defined in proposed paragraph 764A(1)(g)) are brought within the Part 7.9 disclosure regime. The approach taken in the draft provisions is to express the disclosure obligations in terms of general principles capable of application across the full range of financial products. While it is envisaged that for many products the general principles will be sufficient, it is recognised that for some products there will need to be greater specificity in how the general principles will apply.

14.6 In relation to superannuation products, the approach that is to be taken will be the use of regulations to outline in greater detail how the general obligations are to be complied with.

Disclosure requirements for consumer credit insurance

14.7 The provisions include consumer credit insurance within the Part 7.9 disclosure regime. This will replace the specific disclosure requirements for consumer credit insurance under the Insurance Contracts Act. To the extent that more detailed disclosures are currently required under those provisions, they will be dealt with in regulations under Part 7.9.

Which products does the part apply to

14.8 In general the provisions in proposed Part 7.9 will apply to all financial products as defined in Part 7.1, other than securities and debentures, stocks or bonds issued or proposed to be issued by a government. As noted in the discussion in Part 6 of this Explanatory Memorandum, the definition of 'security' for the purposes of proposed Chapter 7 differs from the existing definition in the Corporations Law in that it only includes shares and debentures, and not interests in managed investments schemes. Thus for the most part, the provisions in Part 7.9 do not apply to shares and debentures, but do apply to interests in registered managed investment schemes (proposed section 1010A).

14.9 However, there are some requirements in proposed Part 7.9 which do apply to securities:

- requirements in relation to the confirmation of transaction in proposed section 1017F; and

- short selling provisions in proposed section 1020B.

14.20 Apart from those provisions, securities will continue to be subject to the disclosure obligations in Chapters 6CA (continuous disclosure provisions) and 6D (fundraising provisions) of the proposed Corporations Act.

14.21 There are also other provisions which only apply in respect of certain products including:

- requirements in relation to ongoing disclosure of material changes and significant events will not apply to managed investment products (proposed section 1017B). Managed investment products will continue to be subject to the continuous disclosure which are now to be contained in Chapter 6CA of the proposed Corporations Act;

- periodic reporting requirements will only apply to products with an investment component (proposed section 1017D);

- cooling-off periods will only apply to risk insurance products, investment life insurance products, managed investment products, RSA products and certain prescribed superannuation products (proposed Division 5).

14.22 These provisions and the reasons for their more limited coverage are discussed in greater detail below.

Products issued in the course of a business

14.23 To ensure that one-off or private transactions in relation to financial products do not have to comply with the disclosure and other requirements, the provisions will only apply to financial products that are issued, or will be issued in the course of a business of issuing financial products (proposed subsection 1010B(1)). However an initial public offering of interests in a registered managed investment scheme, even if done on a one-off basis, will be regarded as the issue of a financial product in the course of a business of issuing financial products (proposed paragraph 1010B(2)(a)). This contrasts with the approach taken in relation to financial services licensing, where the view is taken that a company issuing its own shares would not be regarded as being engaged in a financial services business, and would not therefore be required to be licensed.

14.24 Similarly, to ensure that not for profit superannuation funds which might not otherwise be regarded as being in the business of issuing financial products are subject to the disclosure requirements, the issue of any superannuation product is taken to occur in the course of a business of issuing financial products (proposed paragraph 1010B(2)(b)).

Which clients do the provisions apply to

14.25 As a general rule proposed Part 7.9 will only apply in relation to dealings with retail clients (see discussion of definition of retail client in Part 6 of this Explanatory Memorandum). That is, PDSs and other disclosure documents will only be required to be given to retail clients. The only exceptions to this general rule are the requirements in relation to the handling of client money in proposed section 1017E and the prohibition on short selling in proposed section 1020B.

14.26 In some of respects this may involve a narrowing of existing legislative requirements. For example, the current provisions in Chapters 7 and 8 of the Corporations Law dealing with the confirmation of transactions (sections 842 and 1206) are not limited in their application to a particular class of clients, but apply to all transactions. Similarly, the Customer Information Brochure requirements under Life Insurance Circular G.I.1 are not limited to particular types of persons.

14.27 Although the proposed legislative provisions only apply in relation to retail clients, this would not prevent people from complying with them in relation to all clients if they so wished.

Product Disclosure Statements

14.28 Division 2 of proposed Part 7.9 deals with point of sale disclosure in relation to all financial products other than securities (as defined in proposed section 761A). The broad objective of point of sale disclosure obligations is to provide consumers with sufficient information to make informed decisions in relation to the acquisition of financial products, including the ability to compare a range of products.

14.29 However, there is considerable debate as to the most effective way of achieving this objective. Often there are tensions between the desire to give consumers all the information they require to make a decision and the need to ensure that consumers can, and do, read and understand the information given to them. This debate is reflected in the range of existing point of sale disclosure requirements. At one end of the spectrum is the due diligence approach adopted in section 710 of the existing Corporations Law in relation to securities, which requires the disclosure of all information that investors and their professional advisers would reasonably require to make an informed assessment of the rights and liabilities attaching to the securities and the assets and liabilities, financial position and performance, profits and losses and prospects of the body offering the securities. At the other end of the spectrum is the Key Features Statement approach adopted in relation to superannuation reflected in a determination under section 153 of the SIS Act which requires disclosure under specific headings.

14.30 The provisions adopt a mid-way approach between these two extremes requiring disclosure in a PDS against a specific list of items in so far as those items are relevant to the particular product being offered to aid comparability of products. Disclosure is also required of any other material information known to the product issuer and not required to be disclosed under a specific head which might reasonably influence a client's decision to acquire the product to ensure as far as possible that consumers have all relevant information to assist their decision making. Unlike section 710 of the existing Corporations Law, this is not intended to require product issuers to undertake a due diligence exercise to discover all material information.

14.31 The provisions also seek to achieve regulatory neutrality as between the competing investment vehicles of managed investments, superannuation and the investment components of life insurance. This is achieved by taking managed investments out of the fundraising provisions of the existing Corporations Law and subjecting them to the same directed disclosure requirements as superannuation and the investment components of life insurance.

Geographical coverage

14.32 The proposed provisions adopt the approach of the fundraising provisions of the existing Corporations Law (subsection 700(4)) of applying the PDS requirements to offers or recommendations that are received within the jurisdiction (proposed section 1011A). Thus the provisions could potentially apply to offers or recommendations included on the Internet in any jurisdiction if they are accessible by persons in Australia and could be regarded as being received in Australia.

14.33 In relation to the fundraising provisions of the Corporations Law, ASIC has released a policy statement (ASIC Policy Statement 141) indicating when it will regard Internet offers as being received in the jurisdiction. That policy statement indicates that ASIC will not regulate offers, invitations and advertisements of securities that are accessible in Australia on the Internet if:

- the offer, invitation or advertisement is not targeted at persons in Australia;
- the offer or invitation contains a meaningful jurisdictional disclaimer;

- the offer, invitation or advertisement has little or no impact on Australian investors; and
- there is no misconduct.

14.34 Jurisdictional disclaimer in this context means making it clear that the offer or invitation is only available to residents of certain countries, not including Australia, or that it is not available to Australians.

When is a Product Disclosure Statement required to be given

14.35 Proposed Subdivision B of Division 2 seeks to require the giving of a PDS at the earliest possible time when a retail person is considering the acquisition of a financial product. Broadly, there are three situations in which a PDS is required to be given:

- when personal advice recommending a particular financial product is made;
- when an offer of a financial product for issue is made, when a person offers to acquire a financial product by way of issue or when the product is issued;
- in certain limited circumstances, when a financial product is offered for sale or when a person offers to acquire a product by way of transfer.

Recommendation situation

14.36 A PDS will be required to be given when a regulated person (as defined by proposed section 1011B) provides personal advice to a retail client which includes a recommendation that the client acquire a particular financial product (see proposed subsection 1012A(3)). Personal advice is defined in proposed subsection 766B(3).

14.37 Generally the provision will only apply to recommendations that a person acquire a product by way of issue, rather than by way of transfer. However, to the extent that sales of financial products require the giving of a PDS under proposed section 1012C, personal advice recommending the acquisition of a product in those circumstances will also require the giving of a PDS (proposed subparagraph 1012A(3)(b)(ii)).

Issue situation

14.38 Generally the requirement to give a PDS will only apply on the initial issue of a financial product and not on the subsequent sale of the product. Issue is defined inclusively in proposed section 761E as:

- a person becoming a member of a superannuation fund;
- the opening of a RSA;
- in relation to a derivative, entering into the legal relationship that constitutes the financial product. This would capture both sides of a derivatives transaction, both the acquisition and the writing or selling of a derivative.

14.39 It would also encompass:

- the opening of a bank account;
- entering into a contract of insurance;

- taking up an interest in a managed investment scheme; and
- making further contributions to a superannuation fund.

14.40 Regulations may also further elaborate on the meaning of issue (proposed subsection 761E(7)).

14.41 The requirement to give a PDS will arise in three circumstances associated with the issue of a financial product:

- when a person makes an offer to issue, or arrange for the issue, to a retail client of a particular financial product. This is intended to cover the circumstance where a product issuer or financial services licensee offers a particular financial product to a person, including for example direct marketing campaigns (see proposed subsection 1012B(3));
- when a product is issued to a person in circumstances where it is reasonable to believe that the person has not received a PDS. This is intended to cover the situation where there is no offer to issue or acquire at all or where the offer is made to or by a person other than the person to whom the product is issued. For example, in relation to some superannuation products, the offer to issue may be made to the employer while the product is issued to the employee. It is intended that in this circumstance the employee receive a PDS prior to the issue of the product (subject to special timing requirements for certain superannuation products provided for in proposed section 1012F) (proposed subparagraph 1012B(3)(a)(iii)); or
- when a retail client makes an offer to acquire a financial product. This is intended to cover situations where a person approaches a product issuer or a financial services licensee seeking a particular financial product. For example, when a person approaches a bank seeking to open a bank account or telephones an insurance company wishing to take out a particular insurance policy (proposed subsection 1012B(4)).

14.42 The term offering to issue is defined broadly, along the lines of existing section 700 of the Corporations Law (as inserted by the CLERP Act), to include inviting applications for issue (proposed paragraph 1010C(2)(a)).

Sale Situation

14.43 There will, however, also be a limited range of secondary sale situations in relation to which there will be an obligation to give a PDS. These provisions are modelled on the anti avoidance provisions in current section 707 of the Corporations Law (as inserted by the CLERP Act). While it is envisaged that these provisions will largely only have application to the secondary sale of interests in registered managed investment schemes, they will have the potential to apply across the full range of financial products in relevant circumstances.

14.44 The sale situations that are covered by the proposed provisions are:

- off-market sales by controllers (as defined in section 50AA of the proposed Corporations Act) (proposed subsection 1012C(5));
- sales within 12 months of issue that amount to an indirect issue (proposed subsection 1012C(6)); and
- off market sales within 12 months of sale by controllers that amount to an indirect issue (proposed subsection 1012C(8)).

14.45 A sale will be regarded as an indirect issue if the product is sold with the purpose of the person to whom it is sold on-selling it or granting, issuing or transferring interests in, or options or warrants, over it. A sale within 12 months will be regarded as having this purpose and therefore amounting to an indirect issue unless the contrary is proved (proposed subsections 1012C(7) and (9)).

Group financial products

14.46 Product issuers will also be required to ensure as far as reasonably practicable that prospective beneficiaries under group financial products, such as group insurance products, receive a PDS before they elect to be covered by the product. Proposed section 1012H has been modelled on the effective purchasing decision approach in the Choice of Superannuation Funds (Consumer Protection) Bill.

Employer-sponsors of superannuation funds

14.47 Proposed section 1012I brings within the FSR Bill the requirements in the SIS and RSA Acts to provide employers with information about superannuation and RSA products that they are applying for on behalf of their employees.

Exceptions to the requirement to give a Product Disclosure Statement

Client has already received a PDS

14.48 As there are a number of trigger points for the requirement to give a PDS which may occur at different stages of a transaction to acquire a financial product, there is the potential for a client to receive a number of PDSs in relation to the same financial product. For example, a client may receive advice in relation to a particular product and receive a PDS at that time, then at some later time could seek the product from the issuer and potentially receive a further PDS.

14.49 This situation is addressed in proposed subsection 1012D(1) which provides that a PDS need not be given if a client has already received an up-to-date PDS or the regulated person reasonably believes that this is the case. However, if there has been a material change in the information that was contained in the PDS which would require the giving of a new or supplementary PDS, the fact that the person has already received an outdated PDS does not obviate the need to give them a new or supplementary one (see discussion of supplementary Product Disclosure Statements below).

Client already holds product and has access to up to date information

14.50 Where a person already holds a financial product and they are seeking to acquire or are being advised to acquire a product of the same kind they will not need to be given a further PDS if they have received or have access to all the information that a PDS would be required to include through an earlier PDS and any ongoing disclosures, periodic reports or, in relation to managed investment products, through continuous disclosure under proposed Chapter 6CA (proposed subsection 1012D(2)). Access to in this context is intended to mean that the person knows of their right to obtain the information and it is reasonably likely that they will have exercised that right. Generally it would apply to information that is generally available in the public arena. It is not intended to encompass the fact that a person could have obtained the information if they had asked for it if it is not widely known by reasonable retail clients that such information can be obtained on request.

14.51 The provision is intended to cover situations where it would be inappropriate to provide a person with a further PDS because they are already aware, through their existing holding of a product of the same kind, of all the information the PDS would be required to contain. For

example, a person may hold a managed investment product in relation to which they have received a PDS and periodic disclosure and continuous disclosure has been made to the market in a manner accessible to the person. That person may wish to increase the interest they hold in the product. It would be unduly burdensome to both the issuer and the client for a further PDS to be given in such circumstances.

14.52 Proposed subsection 1012D(10) sets out where one financial product is of the 'same kind' for the purposes of this provision.

Offers under distribution reinvestment plans or switching facilities

14.53 Proposed subsection 1012D(3) provides that a PDS is not required to be given to a person who already holds a particular kind of product and is contemplating acquiring more of the product under a distribution reinvestment plan or switching facility. This provision is modelled on subsection 708(12) of the existing Corporations Law (inserted by the CLERP Act) as it relates to managed investments. However, the provision will not be limited to managed investments, but will apply to all financial products that provide such reinvestment plans or switching facilities. The basis for this exclusion is that the client should already have received a PDS in relation to the initial issue of the product and will have received updated information on an ongoing basis under proposed section 1017B.

14.54 Unlike proposed subsection (2) it is not necessary in this case for the regulated person to be satisfied on reasonable grounds that the person has already received or has access to the relevant information. It is assumed that this will be the case in such circumstances.

Additional contributions to an existing product

14.55 A PDS is not required where a person makes an additional contribution to an existing financial product, such as a further deposit to a bank account, a further contribution to a superannuation fund on the same terms as they have done previously and making a further payment under a life insurance investment policy (proposed subsection 1012D(4)).

No consideration to be provided

14.56 A PDS is not required to be given in cases where no consideration is to be paid for the issue or sale of the managed investment product (proposed subsection 1012D(5)). As a general rule, for all other financial products a PDS will be required notwithstanding that no consideration is paid for the product. This approach has been taken on the ground that in relation to financial products other than managed investments there may be an opportunity cost to the person in taking up the free product. If the person had not received the product free they may have chosen to pay for a similar product. It is important that they know the terms and conditions of the product to enable them to make an informed decision in these circumstances. Even if there is no opportunity cost, the person may be subject to ongoing obligations under the product which they should be informed about.

14.57 Additional products may be prescribed by regulations under this provision. The special circumstance of a financial product that is an option being provided for no consideration is dealt with in proposed subsection 1012D(6). In that case both the option and the underlying product must be provided for no consideration to benefit from the exemption.

Takeovers

14.58 A PDS is not required for the issue or sale of an interest in a managed investment scheme or option by way of transfer over a security under a takeover bid under Chapter 6 of the proposed Corporations Act. In such circumstances the offer will be accompanied by a bidder's statement

which will contain all the necessary information associated with the bid pursuant to section 636 of the proposed Corporations Act (see proposed subsection 1012D(7)). This provision is modelled on subsection 708(17) of the Corporations Law (as inserted by the CLERP Act).

Responsible entity an exempt body

14.59 A PDS is not required in relation to a recommendation or offer where the product being offered is a managed investment product the responsible entity of which is an exempt body. Exempt body is currently defined in section 66A of the Corporations Law and includes bodies such as registered associations, clubs and societies and co-operatives (these provisions were amended by the *Financial Sector Reform (Amendments and Transitional Provisions) Act (No. 1) 1999*).

Interim contracts of insurance

14.60 Proposed subsection 1012D(9) provides that a PDS will not be required to be given in relation to an interim contract of insurance, as defined in subsection 11(2) of the Insurance Contracts Act. However, subject to the exception in relation to the time of giving a PDS discussed below, a PDS will be required to be given prior to the issue of the final contract of insurance. This provision is intended to facilitate the process of issuing interim contracts of insurance (or cover notes) over the phone.

Small scale offerings of managed investment products

14.61 The exemption from the requirement to give a disclosure document in relation to small scale offerings of managed investment products in current section 708 of the Corporations Law is preserved by proposed section 1012E. The provision only applies to managed investment products, but may be extended by regulation to other products. ASIC may make anti-avoidance determinations for the purposes of this provision under proposed section 1012K.

Time for giving the PDS

14.62 The following timing rules are to apply in relation to the giving of the PDS:

- in the recommendation situation the PDS must be given at or before the time the advice is given (proposed subsection 1012A(3)).
- in the issue situation, the PDS must be given either:
  - at or before the time a person makes an offer to issue or arrange to issue or issues the financial product (proposed subsection 1012B(3)); or
  - where there is a client offer, before the client becomes bound by a legal obligation to acquire the financial product (proposed subsection 1012B(4)).
- in the sale situation the PDS must be given either:
  - at or before the time the seller makes an offer to a retail client to sell the product; or
  - where there is a client offer, before the client becomes bound by a legal obligation to acquire the financial product (proposed section 1012C).

Exceptions to the timing requirements

Superannuation products

14.63 Consistent with the current requirements in the SIS Act and regulations, the timing requirements for the giving of a PDS may be relaxed for certain superannuation products. In relation to prescribed superannuation products the PDS need not be given prior to the issue of the product, but may be given up to 3 months after the issue of the product (proposed section 1012F). Which products will be prescribed under this provision will depend on the commencement of the proposed choice of superannuation fund legislation. If that legislation has commenced prior to the commencement of the FSR Bill, only those superannuation products in relation to which there continues to be no choice will be prescribed by regulation. If the choice legislation is not in place prior to the commencement of the FSR Bill, generally only public offer superannuation funds will be required to provide disclosure prior to issuing superannuation products.

Risk insurance products

14.64 To facilitate phone issues of risk insurance contracts proposed 1012G provides an exception to the requirement to provide a PDS prior to the issue of certain products that are subject to a mandatory cooling-off. The exception does not apply to products for which an application form is required to accompany the PDS, notwithstanding that they are subject to mandatory cooling-off periods. In such cases the client would always have the PDS prior to the issue of the product as they must apply for it on an application form that accompanies the PDS.

14.65 At present, therefore, the exception would only apply to risk insurance products, as they are the only products that have a mandatory cooling-off period, but are not required to have an application form accompanying the PDS. However the provision has been drafted more generally to capture any other product that might meet the relevant criteria in the future.

14.66 Where proposed section 1012G applies and:

- the client expressly instructs that they want the advice in relation to the product or the product itself immediately or at a specified time; and

- it is not reasonably practicable to give the PDS when it would otherwise have been required to be given;

The PDS must be given to the client as soon as practicable after that time and not later than the start of the cooling-off period.

14.67 The cooling-off period commences on the earlier of:

- the time when confirmation of the transaction is required under proposed section 1017F — which is as soon as is reasonably practicable after the transaction occurs; or

- the end of the fifth day after the day the product was issued (proposed subsection 1019(3)).

14.68 In addition to the requirement to give the PDS prior to the commencement of the cooling-off period, the product issuer or financial service licensee must give the client an oral statement when the PDS would otherwise have been required to have been given that outlines:

- the essential features of the product;

- any significant risks associated with the product;

- the cost and other amounts payable in respect of the product;
- any significant taxation implications; and
- details of the cooling-off period applicable to the product (proposed paragraph 1012G(3)(a)).

Basic deposit products

14.69 The timing exception provided for in proposed section 1012G also applies to basic deposit products and related non-cash payment facilities and any other products prescribed by regulation (proposed paragraph 1012G(1)(b)).

Who must give the Product Disclosure Statement

14.70 The concept of 'regulated person' is defined in proposed section 1011B and includes:

- product issuers and those sellers covered by proposed section 1012C;
- financial service licensees and authorised representatives;
- persons who are not required to hold a financial service licence because they are a member of a declared professional body or because they are exempt from the licensing requirement;
- persons who should be licensed, but for whatever reason are not. Although a person who should be licensed but is not will be subject to penalties for breach of the licensing provisions, they will also be subject to the product disclosure requirements. This will enable a person who has suffered loss or damage as a result of a failure to receive a PDS to recover that loss or damage in a civil action.

14.71 The provisions would not apply therefore to a person giving financial product advice in circumstances where they are not carrying on a financial services. For example, a person giving financial product advice in a voluntary capacity or on a one-off basis would not have to give a PDS in relation to any recommendation to acquire a particular financial product. However, a product issuer would have to give a PDS if the person subsequently acquired the product by way of issue.

Who must prepare the Product Disclosure Statement

14.72 A PDS must be prepared by or on behalf of either the product issuer or the seller in those limited sale situations for which a PDS is required under proposed section 1012C. Proposed section 1013A refers to the person who is required to prepare the PDS as the 'responsible person'.

14.73 Proposed subsection 1013C(4) permits the badging or branding of products with information about persons other than the product issuer. It enables the product issuer or seller to include information about an association with another person. By virtue of proposed subsection 1013A(4) this information could be included by another person on behalf of the product issuer. Any such information must not include anything that might create the impression that the other person is the issuer or seller of the product. This is based on provisions in Life Insurance Circular G.I.1 issued by the former Insurance and Superannuation Commission.

Who is the product issuer

14.74 The concept of product issuer is defined in proposed section 761E. Generally the issuer is regarded as the person who is responsible for the obligations owed under the product to the client or

a person nominated by the client. This would mean that the following persons would be regarded as product issuers:

- a financial institution making a deposit account available;
- a responsible entity of a managed investment scheme making an interest in a managed investment scheme available;
- an insurance company accepting a risk under a contract of insurance. Even in those circumstances where a broker or an underwriting agent effectively puts together an insurance product, it is considered that the insurance company would be the product issuer. Where there are a number of insurance companies involved in accepting a risk under a particular contract of insurance it is envisaged that they will be jointly responsible for preparing the PDS. Of course it would be open to the insurance company(ies) to authorise the broker or underwriting agent to prepare the PDS on their behalf. However, the company would be responsible for the PDS.

14.75 In relation to OTC derivative transactions, both parties to the transaction will be regarded as the product issuer by proposed subsection 761E(5). However, the retail/wholesale distinction and the precondition that for the product disclosure requirements to apply a product must be issued in the course of a business of issuing products will generally ensure that at the most only one party is subject to the product disclosure requirements. Where both parties are wholesale, neither will be required to disclose, while if one party is wholesale and the other is retail, only the wholesale party will be required to disclose. In the unlikely event that both parties are retail, the business test may operate to ensure that only one has an obligation to disclose.

14.76 In relation to derivatives that are traded on a market, where a financial service licensee is involved in the transaction, they will be regarded as the issuer and required to prepare the PDS. It would be open to the financial market operator to offer assistance to licensees in preparing the PDS if it so wished, but each licensee would be responsible for the content of the PDS (proposed paragraphs 761E(6)(c) and (d)). Where there is no intermediary involved in a derivatives transaction on a market the market operator will be regarded as the product issuer and responsible for the preparation of the PDS (proposed paragraph 761E(6)(e)). This provision anticipates the possibility that under developments for example in electronic trading systems clients may enter into transactions directly on a market.

14.77 The regulations may provide additional circumstances in which a person may be regarded as a product issuer. The regulations may override the general rules outlined in proposed section 761E.

Who must the product disclosure statement be given to

14.78 Generally, the provisions only require the giving of a PDS to a retail client. Disclosure is required to be given to the person receiving the recommendation or the person receiving or making the offer or to the person to whom the product is issued. As noted above, however, in relation to group financial products, product issuers must take reasonable steps to ensure that prospective group members receive disclosure.

Wrap accounts

14.79 So-called wrap accounts are arrangements under which a number of individual financial products are packaged together with other services and offered to a client. The products are purchased by the wrap account provider (who would be required to hold an AFSL) on behalf of their clients. It is intended that the PDS provisions would require the giving of a PDS to the ultimate purchaser of the product and not just to the wrap service provider. It is envisaged that the

wrap service provider would have to provide the PDS to the client either when they recommend the products or when they arrange for the issue of the products to the client.

Content of Product Disclosure Statement

14.80 As noted above, a directed disclosure approach to point of sale disclosure is outlined in the provisions. That approach seeks to balance the need for the purchaser to have sufficient information to make an informed decision and compare products against the concern that they may be provided with more information than they can comprehend. In doing so, it takes a middle ground between the full due diligence approach in the fundraising provisions of the Corporations Law and the Key Features Statement approach taken in relation to superannuation. That is, the provisions take a directed disclosure approach supplemented by other information known to the issuer or seller that might materially influence a retail client's decision to acquire the product.

14.81 The other key feature of the approach taken is that it has been drafted in such a way that it is capable of applying flexibly across the full range of financial products that are subject to the regime. It is envisaged that a PDS for a banking product will be very different from a PDS for a managed investment product in terms of the detail provided. However, there will, through the directed disclosure approach, be sufficient similarity between the documents to enable a consumer to compare them if they so wish.

14.82 This flexibility is achieved in a number of ways:

- the level of information required to be included under a particular topic varies according to the particular product in question. Only the level of information that a retail person would reasonably require for the purpose of making a decision whether to acquire that product needs to be included (see proposed subsection 1013D(1)). This requirement should be read as limiting, not expanding, the disclosure obligation;

- if a particular topic is not relevant to a particular product it need not be included. For example, if there are no significant risks associated with the holding of a particular product, which might be the case in relation to a capital guaranteed banking product, then nothing needs to be included in relation to risks (proposed subsection 1013D(3));

- information only needs to be included in the PDS to the extent that it is reasonable for a person considering whether to acquire the product to expect to find the information in the PDS (proposed section 1013F). Therefore things that are general knowledge and that a reasonable person would not expect to find in a PDS would not have to be included in the PDS. Again, the requirement to provide information that a person would expect to find in the PDS is intended to limit, not expand, the disclosure obligation;

- the list itself is cast in fairly general terms, with the capacity for the information that must be included under particular heads in relation to particular products to be fleshed out in a number of ways:

  - through a regulation making power (see proposed subsection 1013C(4));

  - under an industry code of conduct which may be approved by ASIC (proposed section 1101A);

  - Through ASIC guidance in the form of policy statements.

Directed disclosure

14.83 Proposed section 1013D contains the list of topics that must be included in all Product Disclosure Statements, to the extent that they are relevant to the particular product. It distinguishes between statements and information. In relation to statements all relevant information must be included, for example, the name and contact details of the product issuer. In relation to information, however, only such information under the particular item as a retail person would reasonably require for the purpose of making a decision whether to acquire the financial product needs to be included in the PDS. This will vary from product to product and allow for flexibility in the detail that is to be included under each topic. In addition information need only be included to the extent that it is within the actual knowledge of the persons described in proposed subsection 1013C(2). Unlike the current fundraising provisions of the Corporations Law a full 'due diligence' inquiry is not required by these provisions.

14.84 The topics under which statements or information must be included in the PDS are as follows:

Name and contact details

14.85 For all PDSs this will be the name and contact details of the product issuer. In addition, in sale situations, the name and contact details of the seller are required to be included.

Benefits

14.86 Proposed paragraph 1013D(1)(b) requires disclosure of any significant benefits to which the holder of the product will or may become entitled and the circumstances in which or the time at which those benefits will or might be provided. This would mean, for example, the disclosure of:

- the interest rate on a bank account;
- the payment of a claim under an insurance contract; or
- the payment of an entitlement by a superannuation fund and the circumstances in which that entitlement is to be paid. It would encompass the kinds of information required to be disclosed under clauses 37-39 of the determination made under section 153 of the SIS Act.

Risks

14.87 The PDS must include information about any significant risks associated with the holding of the product. If there are no significant risks, nothing needs to be disclosed under this head. In other cases, the level of detail of disclosure of risks will depend on what a retail person would reasonably require to make a decision to invest in the product. However, information does not need to be included if it would not be reasonable for a person to expect to find that information in the PDS, for example, because it is common knowledge (proposed section 1013F).

14.88 It is envisaged that current disclosures in the IABA in relation to unauthorised foreign insurers would be disclosed here.

Amounts payable

14.89 Proposed paragraph 1013D(1)(d) deals with disclosure of information about amounts that the purchaser of the product must pay.

14.90 To the extent that there is a known upfront price for the purchase of the product, the PDS must include this information. However, for many products this may depend on the particular circumstances of the client, such as in the case of a risk insurance product, or how much the client wishes, for example, to invest in a product or to deposit in a bank account. In these cases, the PDS will not have to include such information, but the person will receive confirmation of the amount of the transaction through the confirmation process outlined in proposed section 1017F.

14.91 The PDS must also include information about any other amounts a holder of the product will or may have to pay in respect of the product, and the times at which those amounts will or may be payable. This would include, for example, entry and exit fees (proposed subparagraph 1013D(1)(d)(ii)). To the extent that fees and charges are deducted from a persons holding in a product (proposed subsection 1013D(2)) or from the overall fund they will also be required to be disclosed (proposed subparagraph 1013D(1)(d)(iii)).

14.92 The provisions do not require the inclusion of a single figure that is indicative of the impact of all fees and charges on a product. Such an approach has not been adopted for two major reasons:

- the calculation of such a single figure requires the making of a range of assumptions, such as the estimated return on the product over a number of years and the length of time the person holds the product. In consequence, the figure may have little relevance to the circumstances of a particular consumer and in some respects may be misleading; and

- there is no industry consensus on whether the figure should be calculated on a time or money weighted basis.

14.93 If it were thought appropriate to provide for a single figure for a particular product or class of products, this could be done through regulations or via an industry code of conduct.

Commissions

14.94 The purpose of commission disclosure at point of sale of the product is to enable the client to assess the likely return on the product. In order to do this, proposed paragraph 1013D(1)(e) requires commissions, or other similar payments, to be disclosed to the extent that they will ultimately impact on the return that the holder of the product will receive.

14.95 Where the commission paid does not affect the return from a product, no disclosure is required. The amount of commission will, however, be reflected in the fees, charges paid by the consumer and disclosed under proposed paragraph 1013D(1)(d). So, for example, commission will not need to be disclosed as a stand-alone item (that is, distinct from the amounts paid by the client to buy the product) for most risk insurance and other non-investment products where the commission does not impact on the return from the product. For the most part, when a consumer purchases a risk insurance product they pay a premium in order to insure against a future risk. If and when that future risk eventuates the consumer will receive the amount for which they were insured. Even though the premium the consumer pays includes a portion that will ultimately be paid to the financial service provider as commission, the payment of the commission will not affect the amount paid if the event occurs.

14.96 It is envisaged that to the extent possible the quantum of commission will need to be disclosed where it impacts on the return on the product. This disclosure will be required to be specified as a dollar amount or as a percentage of the amount paid. Where disclosure in this format is not possible, a written description will be required. This will be prescribed by way of regulations.

Any other significant characteristics or features

14.97 In addition to the matters outlined above, the PDS will have to include information about any other significant characteristics or features of the product, or of the rights, terms, conditions and obligations attaching to the product (see proposed paragraph 1013D(1)(f)). This would include, for example, information about preservation requirements in relation to superannuation and information about margining requirements in relation to derivatives.

Dispute resolution

14.98 The PDS will be required to include information about the internal and external dispute resolution procedures that are available to deal with complaints by holders of the product and about how those procedures may be accessed. Proposed paragraph 912A(1)(g) and proposed section 1017G require financial service licensees and product issuers who are not licensees respectively to have internal and external dispute resolution procedures to resolve complaints from people who receive financial services or acquire financial products. Those dispute resolution procedures must be ones approved by ASIC in accordance with the regulations.

Taxation implications

14.99 The PDS must include information about any significant taxation implications of the product that are specific to that kind of financial product. This is intended to pick up only those taxation considerations relevant to particular kinds of products and not those that relate to the particular client's circumstances. For example, the fact that taxation will be paid at the person's normal marginal personal income tax rate on a return from a product is not something that would be required to be disclosed. However, the particular taxation treatment of superannuation products is something that would be required to be disclosed.

14.100 It is not intended that the provision require the detailed disclosure about the operation of taxation laws, but rather that it require the identification of the features of the product that have particular taxation implications.

Cooling-off arrangements

14.101 Disclosure is required of both mandatory and voluntary cooling-off arrangements applying to financial products. Proposed sections 1019A and 1019B provide for mandatory cooling-off in relation to certain financial products.

Other information

14.102 To the extent that the product issuer or seller makes other information available in relation to the product, the PDS must indicate how that information may be accessed. Proposed section 1017A imposes an obligation on a product issuer or seller to provide further information about a product in certain circumstances.

Other information that might influence a decision to acquire

14.103 As noted above, in addition to the list of items that must be disclosed under proposed section 1013D, disclosure is also required of any other information that is actually known to the product issuer or seller and that might reasonably be expected to have a material influence on the decision of a reasonable retail person to acquire the product (proposed section 1013E). This differs from the approach taken in the current fundraising provisions of the Corporations Law in two respects:

- it only requires disclosure of information actually known to the product issuer or seller. Section 710 of the Corporations Law also requires disclosure of information that in all the circumstances the issuer ought reasonably to have obtained by making inquiries. It is this element of section 710 that gives rise to the due diligence obligation; and

- only the information requirements of retail persons, and not also their professional advisers, need to be taken into account.

14.104 Proposed subsection 1013C(2) outlines whose knowledge is relevant in terms of the additional information that must be included in the PDS. It is modelled on subsection 710(3) of the Corporations Law (as inserted by the CLERP Act) and, in addition to the product issuer and seller and their directors, includes:

- an underwriter of the issue or sale of the product;

- financial service licensees who participated in the preparation of the PDS;

- persons who have consented to the inclusion of a statement in the PDS; and

- persons who are named in the statement as having performed a particular professional or advisory function in relation to the issue of the product.

14.105 The limitation on the extent to which information is required to be included in a PDS under proposed section 1013F will ensure that the field of knowledge of such persons is not unduly broad. If it would not be reasonable for a retail client to expect to find the information in the PDS it need not be included.

14.106 However, a person will only be civilly liable for a defective PDS if they are involved in the preparation of the PDS and have caused it to be defective (proposed subsection 1022B(3)).

Need not include if would not expect to find in PDS

14.107 As noted above, information need not be included in the PDS if it would not be reasonable for a retail person considering whether to acquire the product to find the information in the statement (see proposed section 1013F). For example, it may not be reasonable to expect to find a statement in a PDS that ADIs are prudentially regulated. This is based on paragraph 710(1)(a) of the Corporations Law (as inserted by the CLERP Act). Proposed subsection 1013F(2) sets out a range of factors that may be taken into account in assessing whether it would be reasonable for a person to expect to find information in the PDS.

Other information that must be included in PDS

Dating

14.108 To assist regulated persons in determining whether a client has received an up-to-date PDS, the PDS must be dated. This is either the date the PDS is lodged with ASIC (see discussion of lodgment below) or the date when the preparation of the PDS is completed. Special dating requirements apply in relation to PDSs that are contained in more than one document (proposed subsection 1013L(5)).

Products traded on a financial market

14.109 If a PDS indicates that the financial product is to be traded on a financial market, further information must be included in the PDS indicating either that the product is able to be traded or

that steps have been taken to ensure that it will be able to be traded (proposed section 1013H). This provision is modelled on subsection 711(5) of the Corporations Law (as inserted by the CLERP Act).

Statement in relation to lodgment

14.110 If the PDS is required to be lodged with ASIC (see discussion below), a statement to this effect and indicating that ASIC is not responsible for the content of the document must be included in the PDS (see proposed section 1013J).

Statements made by persons in the PDS

14.111 The provisions envisage that the PDS may include statements that are attributable to particular people, for example auditors. However, such statements may only be included if the person to whom they are attributed has consented to the inclusion of the statement in the form and context in which it is included in the PDS (proposed section 1013K).

PDS may consist of two or more documents

14.112 The provisions do not permit material to be incorporated in the PDS by reference along the lines of the approach taken in relation to disclosure documents under the fundraising provisions of the Corporations Law on the basis that it is envisaged that the PDS will be a much shorter document than a prospectus and should not require detailed material to be incorporated by reference. The view has been taken that the PDS should on its face contain all the material information that a retail person would require to make a decision to acquire the product and that they should not have to seek additional material information that is necessary for them to make a decision.

14.113 The provisions will not prevent additional information that may assist a person or their financial services adviser in making a decision, but that is not material to the decision making process of the retail person, being included in the PDS or being incorporated into the PDS by reference (see proposed paragraph 1013C(1)(b)).

14.114 Although the provisions do not provide for incorporation by reference, they do address one of the concerns that incorporation by reference is intended to address. It is recognised that certain information that is required to be included in a PDS may be susceptible to frequent change, such as the return on the product or other financial information, making it difficult to maintain an up-to-date PDS. In addition there may be generic information that applies to a number of products which it would be burdensome to individually include in all PDSs. Proposed section 1013L addresses this by allowing a PDS to consist of two or more documents that must be given at the same time. Thus a PDS may consist, for example, of one document containing core product information that is unlikely to change, another document containing performance information that may change annually and a further document including information about fees and charges that may be subject to change more frequently.

14.115 Provided these documents make clear what the whole package of documents making up the PDS is and they are handed over to the client at the same time they will be regarded as a single PDS.

Updating the Product Disclosure Statement

14.116 No limit is to be placed on the time a PDS can remain current. However, where a document becomes out of date, the product issuer or seller must either:

- In relation to new recommendations or offers:

  - withdraw the PDS and provide a new PDS. This could be done by updating one of the documents that make up the PDS or by using insertions or stickers on an existing PDS — the altered document would be regarded as a new PDS if the alteration was material (proposed section 1015E) ; or

  - supplement the existing document;

  - where applications have already been received pursuant to the old PDS, pursue the procedures outlined in proposed section 1016E for dealing with those applications.

Supplementary Product Disclosure Statements

14.117 Proposed subdivision D outlines the purpose and content of a supplementary PDS. As with the PDS, a supplementary document must include a title, in this case, Supplementary Product Disclosure Statement (which may be abbreviated other than at the front of the document to SPDS) (see proposed section 1014B).

Effect of giving Supplementary PDS

14.118 Where a person has a PDS and is given a supplementary PDS, the PDS is taken to include all the information contained in the SPDS (see proposed section 1014D). This provision is modelled on subsection 719(4) of the existing Corporations Law (as inserted by the CLERP Act).

Circumstances where only Supplementary PDS need be given

14.119 Where a person already has an outdated PDS the obligation to give an up-to-date PDS can be satisfied by giving them a supplementary PDS (proposed section 1014E).

Applications received under outdated PDS

14.120 Proposed section 1016E outlines the options that are available to an issuer or seller in dealing with applications that have been received pursuant to a PDS that is outdated. The PDS may be outdated for a number of reasons:

- a minimum subscription condition has not been met;

- a statement in relation to the ability of a product to be traded on a financial market has not been met in a specific time frame;

- the issuer or seller becomes aware that the document contains a misleading or deceptive statement or there is an omission and that statement or omission is materially adverse from the point of view of a retail person; or

- a new circumstance has arisen which would have been required to be included in the PDS that is materially adverse from the point of view of a retail person.

14.121 The options available to the issuer or seller in those circumstances are either to:

- repay the money received from applicants;

- give applicants a supplementary PDS and the opportunity to withdraw their applications; or

- issue or sell the products to the applicants, but give them a supplementary PDS and an opportunity to return the financial products and be repaid.

14.122 If the issuer or seller fails to exercise any of these options in proposed subsection 1016E(2) the applicant has the right to return the product and have the money they paid to acquire the product repaid (see proposed section 1016F). In these circumstances the applicant has the right to have the full amount of the money they paid for the product repaid. This is in contrast with the position where a right of return under a cooling-off period is exercised. The reason for the difference is that in the case of a defective disclosure document, the applicant has received something different from the description in the PDS. A right to return under a cooling-off period can be exercised even though the PDS accurately described the product and the product issuer was not in breach of any legislative requirement.

14.123 Regulations under proposed subsection 1016F(7) will deal with the special situation of returning products in the context of preservation requirements for superannuation products.

Lodgment of Product Disclosure Statements

14.124 Product Disclosure Statements in relation to managed investment products that are either traded on a financial market or it is intended will be traded will be required to be lodged with ASIC. There will be the facility for regulations to extend the range of products to which the lodgment requirement applies (proposed section 1015B). The provisions will also apply to supplementary PDSs.

14.125 Lodgment will not involve any pre-vetting of the PDS by ASIC. However, a consequence of lodgment is that products, except for those traded on a financial market, cannot be issued or sold until seven days after the PDS is lodged. ASIC will be able to extend the period in which products cannot be issued or sold to 14 days (proposed section 1016B). This provision does not apply to supplementary PDSs and is based on subsection 727(3) of the Corporations Law (as inserted by the CLERP Act).

14.126 For those products for which the PDS is not required to be lodged, the issuer or seller must inform ASIC when they begin to use it and keep a copy of it for seven years and make copies of it available to ASIC and, where reasonable, to others (proposed section 1015D).

14.127 The basis of the distinction between those products for which the PDS is required to be lodged and those for which it must be kept by the product issuer or seller is that the former are likely to be more complex products giving rise to more detailed PDSs. In addition, some of the products for which lodgment is not required may be highly personalised to the particular client and a lodgment requirement could be burdensome.

Electronic commerce

14.128 Consistent with the approach in the fundraising provisions of the Corporations Law (as inserted by the CLERP Act) the proposed provisions will facilitate the issue of a PDS in electronic form as well as paper documents (see for example proposed section 1015C). The regulations may specify requirements for documents to be given in electronic form (proposed paragraph 1015C(5)(b)).

Other obligations that must be met prior to the issue or sale of a product

Application forms

14.129 Certain financial products will not be able to be issued or sold unless the product was applied for using an application form included in or accompanying a PDS or copied or derived from such a form (proposed section 1016A). The products that this provision applies to are managed investment products, superannuation products, investment life insurance products and other products prescribed by regulation. This is consistent with current provisions in the Corporations Law, the SIS Act and the Life Insurance Circular G.I.1.

14.130 In relation to these products, the requirement for an application form included in or accompanying the PDS is one way of enabling the product issuer or seller to satisfy their obligations to ensure that the applicant has received an up-to-date PDS prior to the issue of the product.

14.131 While application forms will not be required in relation to other products, it will be open to product issuers to use application forms if they so wish. Any application form used would, of course, be subject to the general prohibition on misleading and deceptive conduct.

Minimum subscription conditions

14.132 Proposed section 1016C, which is modelled on subsection 723(3) of the Corporations Law (as inserted by the CLERP Act), requires any minimum subscription condition attaching to a financial product to be satisfied prior to the issue or sale of the product. In the event that the condition is not satisfied and the issuer or seller still wishes to issue or sell the product, it would be open to them to modify the PDS through a supplementary statement.

Condition about ability to trade

14.133 Proposed section 1016D permits the issue or sale of a product in relation to which there is a statement that it will be able to be traded on a financial market only if the product is able to be traded on that market or an application has been made within the relevant time frame for it to be traded. If such an application has not been made or the product is not able to be traded within 3 months any issue of the product is void and the issuer must return any money paid.

Additional information on request

14.134 A product issuer or seller who has prepared a PDS will be required to provide certain additional information about the product on request to a person (proposed section 1017A).

What additional information

14.135 Information need only be given on request if:

- it has previously been made generally available to the public;
- it might reasonably influence the decision of a retail person whether to acquire the product; and
- it is reasonably practicable to give the information (proposed subsection 1017A(2)).

14.136 The requirement that the information has previously been made generally available to the public means that a range of confidential information, such as trade secrets or information subject to a duty of confidence, does not need to be disclosed. It also means that information that has been made available to a more limited class of persons, for example in a briefing for financial service licensees, does not have to be provided under this proposed section.

To whom must additional information be provided

14.137 The proposed provision enables the following people to request such information:

- any person who has been given or has obtained a PDS in relation to the product who is not a holder of the product.
- professional advisers such as financial services licensees and their representatives. However, it can only be such information as might reasonably influence the decision of a retail person to acquire the product.

Time of giving of information

14.138 The information must be given as soon as practicable and must make reasonable efforts to comply within one month of the request.

How information is to be given

14.139 Proposed subsection 1017A(4) deals with how information may be given. It is based on provisions in the Superannuation Industry (Supervision) Regulations.

Charge for the giving of information

14.140 A product issuer or seller may charge for the giving of additional information. They may only charge the reasonable cost associated with the giving of the information (proposed subsections 1017A(5) and (6)).

Ongoing disclosure

14.141 Proposed section 1017B establishes a regime for ongoing disclosure of information in relation to products for which a PDS is required. It does not apply, however, to managed investment products. They will continue to be subject to the amended continuous disclosure obligations in proposed Chapter 6CA. This was done on the basis that the continuous disclosure provisions were better able to address ongoing disclosure obligations in relation to listed managed investments and having regard to the fact that the rules of financial markets would impose continuous disclosure obligations for such products in any case.

What must be disclosed

14.142 Disclosure is required where there is a material change to or a significant event affecting any of the information that was required to be included in the PDS. Information that is reasonably necessary for the holder to understand the nature and effect of the will have to be disclosed.

To whom must ongoing disclosure be made

14.143 Ongoing disclosure is required to be given to a person who was a retail person when they acquired the product and who was given or obtained or should have been given a PDS for the product. Thus if the person was wholesale when they acquired the product they are not entitled to ongoing disclosure.

How is ongoing disclosure to be made

14.144 Ongoing disclosure may be provided in writing, electronically or in a way specified in the regulations. This would enable, where appropriate, the specification in regulations of alternative methods of notice, such as, for example, advertisements in national newspapers.

When is ongoing disclosure required to be given

Change or event not relating to fees or charges

14.145 If the change or event is adverse to the holders' interests it must be disclosed:

- before the change or as soon as reasonably practicable after it;
- in any case, within three months after the change.

14.146 If the change or event is not adverse to the holder's interest it must be disclosed no later than 12 months after the change. For financial products with an investment component, such changes could be notified in a periodic statement required to be given under proposed section 1017D.

Change or event relating to fees and charges

14.147 Changes or events relating to fees and charges must be notified 30 days before it takes effect. requirement.

Information to existing holders of superannuation and RSA products

14.148 Proposed section 1017C brings across from the SIS Regulations the annual member information requirements. The fund information requirements will also be brought across in subsequent consequential amending legislation.

Periodic Statements

14.149 Proposed section 1017D establishes a regime for periodic reporting in relation to financial products that have an investment component. It will apply to managed investment products, superannuation products, RSA products, investment life insurance products, deposit products and any other product prescribed by regulation.

Reporting periods

14.150 The maximum reporting period is 12 months. However it will be open to a product issuer to provide for more frequent reporting if they so wish. The first reporting period starts when the product is issued to the holder.

14.151 It would be open to product issuers to end the reporting period at the same time for all holders, so that they report on the same date for all holders. This would mean that for new holders they might have a shorter reporting period at the first reporting date than they will have for subsequent reporting periods. For example, a product issuer may report to holders annually for the period from 1 July to 30 June. If a holder purchased the product on 30 September, it would be open to the product issuer to report for that holder for the period 30 September to 30 June (proposed subsection 1017D(2)).

14.152 Subsequent reporting periods will commence at the end of the preceding reporting period.

When the periodic statement must be given

14.153 A periodic statement must be given within 6 months of the end of the reporting period (proposed subsection 1017D(3)).

Content of periodic statement

14.154 Generally the periodic statement must include information that a holder needs to understand their investment. Proposed subsection 1017D(5) provides an indicative list, so far as they are relevant, of things that must be included in the periodic statement. Additional items may be prescribed by regulation.

Holding of application money

14.155 Proposed section 1017E imposes an obligation on product issuers and sellers who are required to prepare a PDS to hold any application money in an account for the applicant until the product is issued or transferred or the money returned. Regulation making powers are included to provide for situations where it is not possible either to return the money or issue the product, for example, because the applicant can not be identified.

Confirmation of transactions

14.156 As a general rule the issuer of a financial product will be required to confirm any transactions by a retail client in relation to that product. Confirmation must be effected as soon as reasonably practicable either by:

- confirmation by the product issuer; or
- establishment of a facility enabling the client to confirm for themselves. The client must consent to the use of such a facility to satisfy the confirmation requirements (proposed section 1017F).

14.157 There are a number of exceptions to this general rule:

- in a sale requiring the preparation of a PDS the seller will be required to confirm the sale;
- in relation to a disposal of a financial product, the regulations may prescribe who is to confirm the transaction. Where a financial service licensee is involved in the disposal of a product on behalf of a retail client, it is envisaged that the licensee will be responsible for confirmation;

- more generally, there will be a regulation making power through which someone other than the product issuer may be required to confirm a particular class of transactions instead of the product issuer. It is intended that provisions similar to the contract note provisions in sections 842 and 1206 of the existing Corporations Law and the regulations made for the purposes of those provisions will be included in the regulations, placing the obligation on a financial services licensee who effects a transaction on a financial market on behalf of a retail client to confirm the transaction;

14.158 Confirmation will not be required in relation to a number of transactions including:

- additional contributions towards a financial product, the timing and amount of which, or the method of calculating the amount of which, was agreed when the product was entered into or are necessary as a result of some external factor such as an increase in a person's salary or the Superannuation Guarantee rate;

- a variation of the rights attaching to a security. Such changes require the approval of shareholders in any case;

- a range of transactions in relation to deposit accounts which do not involve a direct interface with the client, such as crediting interest, withdrawals as a result of direct debit arrangements and debiting fees and charges. The client will be informed about these transactions in the periodic statement (proposed subsection 1017F(4));

14.159 As noted above, the confirmation provisions will apply to all financial products including securities. They will, however, only apply to transactions involving retail clients.

Content of confirmation

14.160 Confirmation must give the client such information as they need, having regard to the information they have received before the transaction, to understand the nature of the transaction (proposed subsection 1017F(7)). Thus the confirmation need not repeat information that was contained in the PDS.

14.161 In particular, the confirmation must include details of:

- the issuer or seller;

- the date and description of the transaction;

- any amount payable by the holder in relation to the transaction. The regulations will deal with the situation where the precise costs of the transaction are not known at the time of confirmation. This may arise, for example, because certain fees and charges are calculated on the basis of the number of transactions performed in a specific period;

- any taxes and stamp duties payable in relation to the transaction. Similarly, the regulations will address the situation where the exact amount of taxes and stamp duties are not known at the time of confirmation; and

- any other matters prescribed by the regulations (proposed subsection 1017F(8)).

Alternative Dispute Resolution

14.162 The financial service licensee provisions require licensees to have both internal and external dispute resolution mechanisms approved by ASIC. While many product issuers will be financial services licensees as they are issuing their own products, some product issuers may distribute their products indirectly through licensees, rather than through their own employees and authorised representatives. Such product issuers will not be required to be licensed. However, they will be required under proposed section 1017G to maintain internal and external dispute resolution procedures approved by ASIC to resolve complaints in relation to alleged contraventions of Part 7.9. Product issuers will not be required to have dispute resolution mechanisms to cover complaints about the product as distinct from disclosures in relation to the product. They may, however, wish to extend their dispute resolution mechanisms to such complaints.

14.163 The same approval criteria as envisaged for the financial service licensee provisions will apply in relation to product issuer dispute resolution mechanisms.

14.164 ASIC will be given power to issue a stop order to prevent a product issuer from distributing its products if it does not have and maintain approved dispute resolution processes.

Advertising and promotional material

14.165 Financial products, other than securities, will be able to be advertised and promoted both before and after the issue of PDSs. The advertisement or promotional material will, however, be required to include certain information where it advertises a particular product or is reasonably likely to induce people to acquire the product. That is, where it is more than image advertising.

14.166 Unlike the existing provisions in relation to securities in subsection 734(3) of the Corporations Law (as inserted by the CLERP Act) proposed section 1018A does not list any factors to be taken into account in determining whether particular advertising is merely image advertising or is reasonably likely to induce people to acquire the product. It will be a question of fact in each case whether particular advertising is reasonably likely to induce people to acquire the product. While the factors in subsection 734(3) are relevant for securities in relation to which there is generally a distinction between the issuing of securities in a company and the core business of the company, for the wider range of financial products covered under proposed section 1018A the issuing of financial products is in fact the core business of the issuer. Thus the factors in subsection 734(3) are less helpful in determining whether particular advertising is mere image advertising.

14.167 The information that the advertisement or promotional material is required to include is:

- the identity of the product issuer;
- either that a PDS is available and where it can be obtained or that it will be made available when the product is released;
- that a person should consider the PDS before making a decision whether to acquire the product.

14.168 There is a range of exceptions to the requirement to include this information which are based on those contained in the Corporations Law modified to reflect the wider range of products to which the provisions will apply.

14.169 There is a specific exception for publishers who publish advertisements in the ordinary course of a media business. This has been extended to electronic media businesses. However, it is

not intended to generally exclude advertising on the Internet from the scope of the provisions (proposed paragraph 1018A(6)(c)).

Cooling-off periods

14.170 A 14 day cooling-off period will apply to the following range of financial products where those products are acquired by retail clients:

- risk insurance products (both general and life);
- investment life insurance products;
- managed investment products;
- superannuation products of a kind prescribed by regulations;
- RSA products

(Proposed sections 1019A and 1019B)

14.171 A retail client who acquires a product of this kind will have a right to return the product to the person who issues the product, or in the limited circumstances described in proposed section 1012C sells the product, to the client. On return of the product, the money paid to acquire the product must be repaid to the client. In various circumstances described in below, the money repaid to the client will vary from the money paid to acquire the product.

Commencement of the cooling-off period

14.172 The 14 day cooling-off period will start on the earlier of:

- the time when the confirmation requirement in section 1017F is complied with; or
- the end of the fifth day after the day on which the product was issued or sold to the client

14.173 The second timing element, the fifth day after the product was issued, has been included to cover circumstances in which either there is no requirement for confirmation in relation to a product to which a cooling-off period applies or there is a confirmation requirement but the confirmation requirement has not been complied with.

14.174 The commencement of the cooling-off period is also relevant in relation to the timing exceptions for the giving of Statements of Advice and PDSs in relation to products to which a cooling-off period applies.

Calculation of the money to be repaid to the retail client

14.175 It is proposed that regulations will be made to cover the following circumstances:

- where the value of the product is linked to the market;
- where a tax has been paid by the issuer in respect of the product and that tax is not recoverable, or that tax has not been paid but does not cease to be payable.

Market linked products

14.176 It is proposed that a regulation will be made covering interests in a managed investment scheme and investment life insurance products that is modelled on section 64B of the Insurance Contracts Act:

- if, on the day on which an investment-linked contract is cancelled or an interest in a managed investment scheme is returned, the amount that would have been the allocation price if the contract had been entered into on that day or the interest issued on that day is less than the allocation price on the day on which the contract was entered into or the interest is issued, the amount otherwise payable is reduced by that amount;

- if, on the day on which an investment-linked contract is cancelled or interest in a managed investment scheme is returned, the amount that would have been the allocation price if the contract had been entered into on that day or the interest issued on that day is greater than the allocation price on the day on which the contract was entered into or interest issued, the amount otherwise payable is increased by the adjustment amount;

- *investment linked contract*: means a contract, the principal object of which is the provision of benefits calculated by reference to units the value of which is related to the market value of a specified class or group of assets of the party by whom the benefits are to be provided;

- *allocation price*: means the amount that represents the value of an investment unit for the purposes of the issue of the contract/interest;

- *investment unit*: means a unit by reference to the value of which benefits are to be calculated.

Tax effected products:

14.177 It is proposed that a regulation will be made modelled on section 64(6) of the Insurance Contracts Act.

- If:

  - a tax of any kind has been paid, or is payable, by the issuer because of the cancellation of the financial product; and

  - either:

    : in a case in which the tax has been paid — the issuer is unable to obtain a refund of the tax; or

    : in a case in which the tax has not been paid — the tax does not cease to be payable as a result of the cancellation of the financial product;

  - the amount that would otherwise be payable is reduced by the amount of the tax.

Treatment of superannuation products and RSAs

14.178 It is proposed that the existing SIS Act cooling-off provisions in sections 170-172 will be carried across to the new regime. The provisions in the SIS Act will be repealed in later legislation.

14.179 It is proposed that the existing RSA Act cooling-off provisions in section 62 will be carried across to the new regime. The provisions in the RSA Act will be repealed in later legislation.

14.180 These provisions will be amended following the passage of the *Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill* to give effect to changes to cooling-off resulting from choice of superannuation funds.

Stop Orders by ASIC

14.181 Proposed 1020E gives ASIC a power to issue stop orders where there is a misleading a deceptive statement in, or an omission from, a disclosure document, a supplement or other disclosure material required to be prepared or any advertising or promotional material. This provision is modelled on, with some modification, the stop order powers in the current fundraising provisions of the Corporations Law (section 739 of the Corporations Law).

14.182 Proposed section 1020E provides that ASIC may issue a stop order in the following circumstances:

- a document or information required to be given under Part 7.9 or an advertisement or promotional material in relation to a product is defective. This would apply to the PDS, any additional information provided, ongoing disclosures and periodic statements and confirmations. It would not apply to disclosures made under the continuous disclosure provisions in Chapter 6CA of the proposed Corporations Act;

- the product issuer does not have or has not maintained approved internal and external dispute resolution mechanisms.

14.183 An order must be in writing and served on the product issuer or, in situations where the seller is required to produce a PDS, the seller (proposed section 1020E(7)).

14.184 There is an obligation on the product issuer or seller to take reasonable steps to notify relevant financial service licensees of the stop order and to ensure the financial service licensees do not recommend or arrange for the issue products under a stop order. Financial service licensees will then be subject to the stop order and be obliged to comply with it unless they did not know of the order (see proposed subsections 1020E(8) and (9)).

Fleshing out the detail of the legislative requirements

14.185 As noted above, the product disclosure provisions are drafted at a level of general principle that is intended to be capable of flexible application across the full range of financial products that are subject to the provisions. It is recognised, however, that in some cases both industry and the regulator will be looking for further guidance on how particular provisions are to apply in relation to particular products and circumstances. It is also acknowledged that the provisions may not apply appropriately in particular circumstances and may require modification. The draft provisions provide a number of mechanisms for both fleshing out the detail and, where necessary, modifying the application of the provisions.

- ASIC will have an exemption and modification power in relation to Part 7.9 (proposed section 1020F). That power will enable ASIC to exempt persons or products from all or specified provisions of the Part, either conditionally or unconditionally, and to modify the application of particular provisions in relation to persons or products. However, ASIC will not be able to extend the scope of the Part to products or persons it would not otherwise apply to through its exemption and modification power (proposed subsection 1020F(3)). ASIC will also be able to provide administrative guidance in the form of policy statements as to what it regards as compliance with the legislative provisions in all, or particular cases;

- in addition to the various specific regulation making powers in provisions in Part 7.9 which enable the detail of the requirements to be fleshed out, there is also a more general regulation-making power which will enable exemptions and modifications from the Part. This power will enable the regulation to extend the scope of the Part by:

  – modifying the provisions so that they apply in relation to persons, products or situations to which they would not otherwise apply;

  – modifying the provisions so that they change the person to whom or by whom a document or information is required to be given (proposed section 1020G).

- the detail of the legislative requirements may also be fleshed out in industry codes of conduct which may be approved by ASIC.

Criminal liability

14.186 Offences for contravening a number of provisions in Part 7.9 are created through the operation of subsection 1311(1). Those relating to PDSs and other statements required to be given under Part 7.9 are located in Subdivision A of Division 7 and are discussed below.

14.187 However, offences related to proposed sections 1015D, 1017A and subsection 1017E(2) are also located in Subdivision A of Division 7.

14.188 Proposed section 1021M makes contravening proposed section 1015D an offence. Strict liability as well an ordinary offence are provided due to the possibility that contraventions of 1015D may be minor or technical in nature (because of the possibility, for example, of contravening proposed subparagraph 1021M(1)(a)(i) by telling ASIC too late). A similar approach is taken in proposed section 1021O in relation to a contravention of proposed subsection 1017E(2) due to the technical nature of the requirements in that provision.

14.189 Proposed section 1021N makes it an offence not to take reasonable steps to comply with proposed section 1017A. This type of offence has been used as it would note be appropriate to make a contravention of proposed section 1017A an offence in all cases, only where reasonable steps have not been taken.

Liability for disclosure document and statements

14.190 The provisions in Subdivision A of Division 7 are somewhat similar to those dealing with disclosure documents or statements in Part 7.7. In particular the approach to liability for authorised representatives is similar.

14.191 Proposed section 1021C defines a ‘disclosure document or statement’ to be a PDS, supplementary PDS or statement required by paragraph 1012G(3)(a) to be read to a person.

14.192 Proposed section 1021I makes it an offence for an unauthorised representative to give out a FSG or supplementary FSG where it has not been authorised by the person required. Proposed section 1021K makes it an offence for a person to give someone a PDS or supplementary PDS which has been altered otherwise than in accordance with the authority of the relevant responsible person where the alteration makes the document defective or more defective.

14.193 Proposed section 1021G provides a general obligation on licensees to take reasonable steps to ensure that authorised representatives comply with the requirements of Part 7.9 in relation to the

provision of disclosure documents or statements. This is consistent with the approach discussed above in relation to liability of licensees for their authorised representatives.

Failure to provide a disclosure document or statement

14.194 Proposed section 1021C makes it an offence to fail to provide a disclosure document or statement where required by Part 7.7. Due to the technical nature of the requirements of giving a disclosure document or statement, a strict liability offence with a pecuniary penalty only is provided in addition to a fault element offence to provide flexibility in enforcement of this provision.

Providing defective disclosure document or statement

Providing a disclosure document or statement knowing that it is defective

14.195 Proposed section 1021D covers the situation where the person who prepared a disclosure document or statement and knows that it is defective gives it to another person:

- in a situation where Part 7.9 requires it to be given;
- in other situations where the other person may rely on it;
- to a third party who may then provide it to someone else in either of the other two situations.

14.196 Proposed section 1021F makes it an offence for a regulated person (other than the preparer) to knowingly distribute a defective disclosure document or statement.

Providing a disclosure document or statement that is defective (whether known to be defective or not)

14.197 Proposed section 1021E is similar to 1021D but it also covers situations where the person preparing the disclosure document or statement may not know that it is defective. In these situations a defence of 'taking reasonable steps' is provided. These provisions do not require defences for authorised representatives as only the person who actually prepared the disclosure document or statement can contravene them.

14.198 There is no equivalent of proposed section 1021D for a person other than a product issuer, this ensures that only the person who prepares a disclosure document or statement is responsible for its content (other than a person who actually knows that it is defective).

People who consent to the inclusion of a statement in a PDS

14.199 Proposed section 1021L relates to people who consent to the inclusion of a statement in PDS or supplementary PDS (see proposed paragraph 1013K(1)(a)). Proposed subsection 1021L(1) makes it an offence to consent to the inclusion of such a statement if it is 'defective'. The default Criminal Code fault element of recklessness would apply to the circumstance that it is defective. Proposed subsection 1021L(2) makes it an offence where a person after consenting to the inclusion of the statement becomes aware that it is defective or that the inclusion of the statement in the PDS or supplementary PDS has made that document defective and the person fails to withdraw their consent. Such a withdrawal would give the responsible person actual knowledge of the defect and would trigger proposed section 1021J discussed above.

When a person finds out that a PDS is defective

14.200 Proposed section 1021J ensures that where a preparer of a disclosure document or statement becomes aware that it is defective, that steps are taken to either rectify the defect or stop giving the document out. It makes it an offence for such a person to fail to take reasonable steps to ensure that any regulated person to whom the document has been provided for further distribution a direction to rectify the defect or stop giving out the document. It is an offence for a regulated person to contravene such a direction. It is also an offence for a regulated person who becomes aware that a document is defective to fail to tell the responsible person.

Formal Requirements

14.201 Proposed section 1021H makes it an offence for a person who prepares a PDS or supplementary PDS to contravene formal requirements relating to them (such as ensuring that 'Product Disclosure Statement' is on the cover of the document or that the document is dated). A person is liable where they actually give out a FSG or supplementary FSG themselves (whether in a situation where one is required or in any other situations where they are reckless as to whether someone may be relied on it) or give it to a third party who may provide it in one of these situations.

14.202 Strict liability applies to whether the document complies with the relevant formal requirements. This is necessary to ensure the effective enforcement of contraventions of these provisions which carry only a low pecuniary penalty and are offences of a technical nature. Otherwise, the fault element of recklessness would apply to this circumstance. Strict liability does not apply to the actual giving or authorising of the statement as the application of the fault element of intention to this conduct would not be particularly difficult to show.

Civil liability

14.203 Subdivision B of Division 7 of Part 7.9 provides people with a civil action for loss or damage. These provisions are similar to those for civil liability in proposed Part 7.7.

14.204 Proposed section 1022B lists the situations where such action can be taken. They are not providing a disclosure document or statement where required or providing a defective one or consenting to (or failing to withdrawal a consent to) a statement in a PDS or supplementary PDS.

14.205 For the purposes of civil liability 'defective' as defined in proposed section 1021B is similar to the definition for criminal liability but does not require the statement of omission to be materially adverse. The 'materially adverse' concept is not appropriate for civil liability as a person must demonstrate that they have suffered loss or damage as a result of the defect. This in itself establishes that the defect was significant without any need for a requirement of 'materially adverse'.

14.206 Proposed subsection 1053B(8) provides that for an action for relating to a defective document or statement there is no liability where the person took 'reasonable steps' to ensure that it would not be defective.

14.207 Proposed subsections 953B(3) and (4) set out who is liable.

14.208 Generally, the licensee is always liable regardless of whether the contravention resulted from conduct of the licensee or an authorised representative. This ensures that clients will always have a licensee to take action against for loss or damage. The only exception is where a person altered a FSG or supplementary FSG without authority from the relevant licensee, in that situation (beyond the control of the licensee) the person who made the alteration is liable. Where more than

one licensee is potentially liable, proposed section 917C is used to determine which licensee or licensees jointly are liable.

14.209 Where the action relates to a defective document or statement, any person involved in its preparation who directly or indirectly caused it to be defective or contributed to it being defective is also liable, in addition to the licensee.

14.210 In addition to the power to being able to recover loss or damage under these provisions, proposed section 1022C also gives the court the power to make additional orders where it thinks these are necessary to do justice between the parties. These orders include declaring a contract void and any additional orders that are necessary or desirable because of that order. These additional orders can include but are not limited to an order for the return of money or payment of an amount of interest.

15

Market misconduct and other prohibited conduct

Market misconduct provisions

15.1 The market misconduct provisions in proposed Part 7.10 are based on the current provisions in Parts 7.11 and 8.7 of the Corporations Law. These have generally been retained in their current form but their scope has been extended, as appropriate, to apply to all financial products and markets.

15.2 A number of the market misconduct provisions will become civil penalty provisions. This means that contraventions will be subject to both civil penalties and criminal consequences. Proposed section 1041I provides for actions for loss or damage for those market misconduct provision which are not also civil penalty provisions. As civil penalty provisions also give rise to a right to take action for loss or damage, this ensures that there is such a right in relation to all market misconduct provisions. Proposed subsection 1041H(4) ensures that the effect of section 1317S of the Corporations Law which provides relief from liability in relation to civil penalty provisions in some circumstances also applies to market misconduct provisions that will not be civil penalty provisions.

15.3 The market misconduct provisions in Division 2 have effect independently and they do not limit the scope of each other (proposed section 1041I).

Financial Services Civil Penalty Provisions

15.4 The civil penalty provisions in proposed Part 7.10 will differ from existing civil penalty provisions. It is proposed that Part 9.4B will be amended so that existing civil penalty provisions will be referred to as 'corporation/scheme civil penalty provisions' while those in Part 7.10 will be referred to as 'financial services civil penalty provisions'. These proposed amendments are contained in Items 435-444 of Schedule 1, Part 2.

15.5 It is proposed that subsection 1317G(1), which deals with the situations where pecuniary penalty orders may be made, will only apply in relation to corporation/scheme civil penalty provisions. A new subsection 1317G(1A) will be inserted to provide for the circumstances when a person may be liable to pay a civil penalty for a breach of a financial services civil penalty provision. Contraventions will have to materially prejudice the interests of acquirers, disposers or the issuer of the financial product to which it relates or the contravention will have to be serious before court may order the person who contravened the provision to pay the civil penalty.

15.6 Subsection 1317H(1) of the proposed Corporations Act, which provides for the making of compensation orders, will be amended so that it applies only in relation to corporation/scheme penalty provisions. Proposed section 1317HA will deal with compensation orders for financial

services civil penalty provisions. This provision will allow for any person to be compensated for damage suffered as a result of another person's contravention of a financial services civil penalty provision (proposed subsection 1317J(3A)). Damages that may be awarded include profits made by any person resulting from the contravention.

15.7 Section 1317P of the proposed Corporations Act will be amended to clarify that criminal proceedings may be started even if a banning order or disqualification order has been made against the person in relation to substantially the same conduct.

General prohibition on misleading and deceptive conduct

15.8 A general prohibition on misleading and deceptive conduct will be introduced (proposed section 1041H) to replace section 995 of the proposed Corporations Act.

15.9 The new provision will provide a general prohibition on misleading and deceptive conduct which will apply in relation to financial products and services. The provision will apply to corporations and to unincorporated bodies. Contravention of the provision will attract civil liability only through proposed section 1041I.

15.10 The new provision will not apply to misleading or deceptive takeover, compulsory acquisition and fundraising documents or disclosure documents or statements as defined in proposed Parts 7.7 and 7.9. Chapters 6B and 6D of the Act together with Parts 7.7 and 7.9 provide self-contained liability regimes for these types of documents (see proposed subsection 1041H(2)). The application of a misleading and deceptive conduct requirement in these circumstances would defeat the specific defences included in these regimes such as, for example, the due diligence defence in section 731 of Chapter 6D.

State and Territory Fair Trading Acts

15.11 Proposed section 1041K deals with the interaction with State and Territory Fair Trading Acts. It replaces section 995A of the proposed Corporations Act. It states that the Division will only operate to the exclusion of State and Territory Fair Trading Acts in relation to the specialist disclosure regimes described above. This will enable concurrent operation of State and Territory Fair Trading Acts to the greatest extent possible while still providing the proposed Corporations Act with a self-contained liability regime in relation to financial products and services.

Market manipulation

15.12 Sections 997 and 1259 of the proposed Corporations Act will be replaced by a new provision (proposed section 1041A) based on section 1259, but applying to all financial products traded on a financial market. The new provision will be a civil penalty provision so that a contravention could attract both civil penalty and criminal consequences.

15.13 As is currently provided in section 1259, the new provision will apply to a transaction, or two or more transactions, with the effect of creating or maintaining an 'artificial price'.

False trading and market rigging

15.14 Sections 998 and 1260 of the proposed Corporations Act will be replaced by two provisions (proposed sections 1041B and 1041C) based on section 1260, but applying to all financial products traded on a financial market. The new provisions will be civil penalty provisions.

15.15 Subsections 1260(2) and (3) of the Corporations Law are replicated in proposed section 1041C. Subsection 1260(1) is contained in proposed section 1041B. In addition, the deeming provision in subsections 998(5) and 998(7) that provides an example of what constitutes creating a 'false or misleading appearance' will be retained in proposed section 1041B.

Dissemination of information about illegal transactions

15.16 Sections 1001 and 1263 of the proposed Corporations Act will be replaced by a proposed section 1041D which is based on section 1263, but applying to all financial products. The new provision will be a civil penalty provision.

False or misleading statements

15.17 Sections 999 and 1261 of the proposed Corporations Act, which are identical apart from their application to securities or futures contracts, will be replaced by proposed section 1041E that applies to all financial products.

Fraudulently inducing persons to deal

15.18 Sections 1000 and 1262 of the proposed Corporations Act, which are identical apart from their application to securities or futures contracts, will be replaced by proposed section 1041F which will apply to all financial products. Proposed paragraph 1041F(1)(a) covers situations where a person knows or is reckless as to whether a statement is misleading, false or deceptive. As a consequence, an equivalent of paragraph 1001(1)(a) of the Corporations Law, which deals with the reckless making or publish of certain statements, has not been included.

Dishonest Conduct

15.19 A prohibition on people, in the course of carrying on a financial services business, engaging in dishonest conduct in relation to a financial product or service is contained in proposed section 1041G. A contravention of this provision will lead to criminal consequences and is also a civil penalty provision.

Insider trading

15.20 Division 2A of Part 7.11 (sections 1002 to 1002U) and Division 1 of Part 8.7 (sections 1251 to 1257) of the proposed Corporations Act will be replaced by the insider trading provisions in Division 3 of Part 7.10. These provisions are based on Division 2A of Part 7.11 of the Corporations Law.

15.21 The new provisions will apply to securities, derivatives, managed investment products, superannuation products (other than those exempted by regulation) and any other financial products traded on a financial market.

15.22 The new insider trading provisions will also be financial services civil penalty provisions.

15.23 The proposed provisions are Criminal Code compliant, which has required amendments to the fault elements that are contained in proposed section 1043A. This has generally required replacing the concept of 'knows or ought reasonably to know' in current section 1002G with the concept of knowledge or recklessness. This subjective fault element is more appropriate to a serious offence carrying a maximum penalty of five years imprisonment and will promote certainty in the operation of the offence. It will apply to any person who is aware of a substantial risk of the relevant matter (see definition of 'recklessness' in the Criminal Code), whereas previously it was necessary to demonstrate either that the defendant had actual knowledge or that they ought reasonably to have had actual knowledge.

Civil liability for contravention of market misconduct provisions

15.24 Currently, section 1005 of the Corporations Law provides for civil liability for contraventions of the market misconduct provisions. It will be retained (see proposed section 1041H) to the extent that it applies to market misconduct provisions which will not become civil penalty provisions. Civil liability for contraventions of the market misconduct provisions that will become civil penalty provisions will be provided for in Part 9.4B of the Act (see paragraph 15.6). The defence for publishers in subsection 1005(4) will also be preserved as proposed section 1044A.

15.25 Section 1013 of the Corporations Law provides for civil liability in respect of insider trading. An equivalent of this provision will be retained as proposed section 1043L.

16

Title and transfer

Preliminary

16.1 Proposed Part 7.11 will replace Part 7.13 of the Corporations Law. In brief, it will:

- omit the special position of the ASX's Securities Clearing House (SCH); and
- provide for the detailed procedural provisions to be made in the regulations.

16.2 The purposes of the changes referred to briefly above are to facilitate competition between clearing and settlement facilities in the settlement of, at least, securities transactions and to provide greater flexibility in procedure to accommodate future developments.

16.3 It should be noted that 'security' in Part 7.11 includes a managed investment product. This is indicated in the definition of 'security' in section 761A. The scope of 'security' is indicated in the relevant provision, or Division.

Divisions 1 and 2 — Title to and transfer of certain securities

16.4 Divisions 1 and 2 of proposed Part 7.11 largely reproduce the provisions currently found in Division 1 and 2 of Part 7.13 with the following changes. The new provisions:

- refer to prescribed clearing and settlement facilities (and their operating rules) rather than to the ASX's SCH (and its business rules);
- refer to regulations (where the relevant provisions are to be moved from the Act into the Regulations);
- correct several cross-references;
- extend some provisions to units in managed investment schemes; and
- make some minor drafting improvements.
  - These include shorter sentences and the reordering of provisions so that groups of sections will deal with the same types of interests.

16.5 Thus:

- the nature of shares and certain other interests, the numbering of shares, matters to be specified in share certificates and the loss of title documents for certain securities are addressed in proposed sections 1070A to 1070D (Division 1);

  – they are currently addressed in sections 1085-1089;

- general provisions relating to the transfer of certain securities, including provisions regarding refusal to register transfers, the duty to issue certificates, certification of transfers and the instrument of transfer are addressed in proposed sections 1071A to 1071H (Division 2 Subdivision A);

  – they are currently addressed in sections 1091 to 1096 and 1111;

- special provisions relating to shares, including a number of relevant replaceable rules (for example, transmission of shares on mental incapacity), are addressed in proposed sections 1072A to 1072H (Division 2 Subdivision B);

  – they are currently addressed in sections 1091AA to 1091E, and 1096A.

Definition of 'Issue'

16.6 In addition, while the current provisions refer to 'allotment' (for example, section 1096), the comparable proposed provision refers to 'issue'. The proposed change is in line with the CLERP Act and would not appear to alter the obligations in the relevant provisions (although it is acknowledged that allotment and issue are separate steps).

Division 3 — Transfer of certain securities effected otherwise than through a prescribed clearing and settlement facility

16.7 The purpose of proposed Division 3 is to replace Subdivision B, Division 3 of Part 7.13 of the Corporations Law (that is, sections 1099A to 1109) and the relevant definitions in Subdivision A.

Procedural requirements to be moved into the regulations

16.8 The major change will be to move the detailed procedural requirements (including the forms currently found in Schedule 2) into the regulations.

16.9 The reasons for doing this are:

- it is inappropriate to clutter the Act with detailed procedural requirements such as what is a sufficient transfer by an authorised trustee corporation, and the effect of a broker's stamp on a transfer; and

- it will allow greater flexibility to adapt the requirements to developments in the industry, and more efficient procedures which may emerge.

16.10 This will be facilitated by the regulation-making power in proposed section 1073D which empowers the making of regulations about, among other things:

- the way a security may be transferred;
- the legal effect of a proper or sufficient transfer of a security and the relevant rights, liabilities and obligations on persons involved in the transfer;
- what is a sufficient transfer; and
- offences connected with these matters.

Additional amendments

16.11 In addition the following amendments have been made:

- in place of the current definitions of 'marketable security', 'marketable right' and 'prescribed security', proposed subsection 1073A describes the kinds of securities (including managed investment products) to which proposed Division 3 applies;
- in place of the definition of 'eligible body' in current subsection 1097(1), proposed section 1073C provides that proposed Division 3 applies to certain specified bodies as if they were companies;
- in place of current section 1099A, proposed subsection 1073D(1) provides that the regulations do not apply to a transfer of a security effected through a prescribed clearing and settlement facility;
- in place of section 1113A, proposed section 1073E provides for ASIC's power to extend the regulations to securities otherwise not covered by the regulations.

Division 4 — Transfer of financial products effected through a prescribed clearing and settlement facility

16.12 The aim of these provisions is to be facilitative (offering efficiencies to the financial services industry), rather than requiring that financial products be transferred in a particular way.

Prescribed clearing and settlement facilities

16.13 The basic purpose of proposed Division 4 is to support transfers effected through prescribed clearing and settlement facilities, in a manner comparable to the support currently provided to SCH-regulated transfers under Subdivision C, Division 3 of Part 7.13 of the Corporations Law.

16.14 What is crucial is that the transfers are effected through a prescribed clearing and settlement facility. It is not relevant whether the transaction was entered into on-market or off-market.

16.15 Proposed Division 4 therefore uses a new concept — the prescribed clearing and settlement facility (see proposed section 761A). This is defined as a licensed clearing and settlement facility which is prescribed by the regulations for the purpose.

16.16 It is expected that the Minister will have regard to the adequacy of the arrangements for the transfer of title pursuant to these provisions, and any stamp duty issues arising, before recommending that the clearing and settlement facility be prescribed.

16.17 This consideration will address, among other things, how the difficulties which may result if more than one clearing and settlement facility is handling the transfer of the financial products of

the one issuer have been addressed. (This may arise in connection with a number of issues including those currently addressed in sections 1109N and 1109P.)

16.18 There may also need to be links established between clearing and settlement facilities handling the financial products of the one issuer.

16.19 Ongoing oversight of this and related issue will be provided through vetting of the operating rules. From the time a clearing and settlement facility is prescribed for this purpose, the scope of the operating rules which must be lodged and are disallowable under Part 7.3 expands accordingly.

16.20 The SCH is expected to be prescribed from commencement.

Support for operating rules

16.21 The subject matters relating to the transfer of financial products such a prescribed facility may deal with in its operating rules are described (proposed section 1074C). They include the financial products that may be transferred through the facility. Amendments to the operating rules must be lodged and are subject to disallowance under proposed Subdivision B, Division 3 of Part 7.3.

Regulation-making power

16.22 One of the purposes of these reforms is to remove the special position of the ASX's SCH and facilitate competition between clearing and settlement facilities.

16.23 Thus, it is not appropriate to replicate current Subdivision C, Division 3 of Part 7.13 which includes provisions relating only to the procedure of the ASX's SCH (for example warranties by member organisations whose identification code is included in a transfer document, and determinations of who holds quoted securities for the purposes of a meeting).

16.24 Instead, proposed section 1074E empowers the making of regulations which will cover such issues in relation to the ASX's SCH and any other prescribed clearing and settlement facility licensee.

16.25 Obviously, in relation to the latter, it is not possible currently to craft provisions of the level of particularity that Subdivision C, Division 3 of Part 7.13 provides for the ASX's SCH.

16.26 Putting all such provisions in the regulations therefore has the advantages of putting the relevant provisions in the one place (whether they are applicable to the ASX's SCH or some other prescribed clearing and settlement facility licensee), moving detailed procedural provisions out of the Act and accommodating the possibility of new classes of financial product being transferred this way.

16.27 In brief, proposed section 1074E provides for the making of regulations in relation to, among other things:

- transfers of financial products effected through a prescribed clearing and settlement facility, in accordance with its rules;

- the legal effect of such a transfer, and the rights, liabilities and obligations of a person in relation to it;

- the circumstances in which a person is required to register or not to register a transfer through the facility;
- offences arising from, for example, the use of identifying codes in relation to transfers of financial products; and
- civil liability for contravention of the operating rules in this connection.

Ambit

16.28 The proposed amendments will widen the potential ambit of the provisions which are currently found in Subdivision C Division 3 of Part 7.13 to financial products.

16.29 This does not mean that all financial products will be able to be transferred in this manner. For example, benefits under a retirement savings account cannot be assigned; similarly the transfer of a superannuation interest of a member or beneficiary is generally prevented. Some other products are unlikely to be traded (and hence their transfer is unlikely to be effected through a clearing and settlement facility).

16.30 In addition, there will be limits imposed through:

- the excision of specific products by regulation (proposed section 1074A);
- the conditions on the licence of the clearing and settlement facility which specify the financial products for which it can provide its services;
- the vetting (and possible disallowance) of operating rules of the clearing and settlement facility;
- any need for specific regulations under Division 4 to support the transfer of a particular financial product;
- the body of law relating to conflicts of laws, and the rules of statutory interpretation as to what Division 4 (see particularly proposed section 1074G) will override.

Other assets

16.31 These provisions cannot apply to a class of assets which are not financial products, such as bullion.

16.32 However, a prescribed clearing and settlement facility may wish to provide services in relation to a wider class of assets using the infrastructure established to provide services for financial product transactions.

Effect on current mechanisms

16.33 The proposed provisions will not affect the current mechanism for transferring financial products which are not subject to proposed Division 3 and which are not transferred through a prescribed clearing and settlement facility in accordance with proposed Division 4.

Other supporting provisions

16.34 Other supporting provisions are to be included in the Law:

- if a transfer of a financial product is effected through a prescribed clearing and settlement facility and in accordance with the operating rules of the facility, the transfer is valid and effective for the purposes of any law or instrument governing or relating to the way in which the financial product may be transferred (proposed section 1074D);

- substantial compliance is to be determined under the operating rules of the facility (proposed subsection 1074C(2)(c));

  – This replaces the approach taken in section 1097D.

16.35 Proposed section 1074F, which provides protection from civil liability for a person's contravention of prescribed clearing and settlement certificate cancellation rules, follows current section 1112D.

Common provisions

Operation of Divisions 3 and 4

16.36 Proposed sections 1073F and 1074G, which relate to the operation of Divisions 3 and 4 respectively, are based on current section 1110 (and the definition of 'legal representative' in subsection 1097(1)). In general terms, they addresses the relationship between the provisions of proposed Divisions 3 and 4 and other relevant legislation and instruments, the terms and conditions on which the financial products are sold and the use of other forms of transfer.

Division 5 — exemptions and modifications

ASIC's power to exempt and modify

16.37 ASIC will have extensive powers to grant an exemption from Part 7.11 (and the relevant regulations) or modify provisions (proposed section 1075A).

16.38 Such an exemption or declaration must be gazetted (proposed subsection 1075A(5)).

17

Miscellaneous

17.1 Part 7.12 addresses qualified privilege (Division 1) and various other matters (Division 2).

Qualified privilege

17.2 Division 1 deals with protection from suit in a variety of situations relating to financial markets and clearing and settlement facilities. One of the aims of the relevant provisions is to describe more generally the situations in which qualified privilege applies and thus avoid the need for incremental amendment as has happened in the case of current section 779.

17.3 Section 89 of the proposed Corporations Act assists in the meaning of 'qualified privilege'.

17.4 The protection provided by this Division extends to officers, employees and representatives of the person or body (proposed section 1100D).

Information required to be lodged by Chapter 7

17.5 Division 1 provides qualified privilege and protection from breach of confidence actions where the person is required to give the information to ASIC under Chapter 7 or regulations made for the purpose of the Chapter (proposed subsection 1110A(1)).

Information provided by markets etc to ASIC

17.6 It also provides qualified privilege and protection from breach of confidence actions where the market or clearing and settlement facility licensee, its supervisor or foreign regulator provides information to ASIC in connection with the performance by ASIC of its functions under Chapter 7 of the regulations (proposed subsection 1110A(2)).

17.7 This provision has been included to assist in the free flow of relevant information, particularly between the financial markets, as front-line regulators, and ASIC.

Information provided by markets etc to others

17.8 Qualified privilege will be provided to market and clearing and settlement facility licensees in respect of certain actions (including the giving of information) in connection with, in the case of a market, the exercise of its powers under the operating rules if the licensee believes, on reasonable grounds, that the action is necessary, for example, to ensure that the market operates in a fair, orderly and transparent way (proposed subsection 1110B(1)).

17.9 The provision also refers to the provision of information by a market licensee or clearing and settlement facility licensee to other markets or facilities (proposed subsection 1110B(2)).

17.10 There are limitations, and these are included in proposed subsection 1100B(3). These reflect the current limitations in subsection 779(6) of the Corporations Law.

Provision of information to market licensees etc

17.11 A person who provides information to a market licensee, clearing and settlement facility licensee, its supervisor or a foreign regulator has qualified privilege if the information is in relation to a contravention or suspected contravention of the proposed Corporations Act or the operating rules of the market or facility concerned (proposed section 1100C).

Other matters

Codes of conduct

17.12 The role of codes of conduct will be to establish best practice standards for meeting the requirements of the proposed Corporations Act. While a code cannot derogate from obligations imposed under the Act, it can provide clarification and processes and procedures for meeting the Act's requirements (see proposed section 1101A).

17.13 ASIC will have power to approve a code that is not inconsistent with the proposed Corporations Act or any other law of the Commonwealth under which ASIC has regulatory responsibilities and relating to the activities of financial services licensees, authorised representatives and issuers of financial products.

17.14 In exercising its approval powers, ASIC will be required to take account of the benefit of having codes of conduct harmonised to the greatest extent possible to ensure consistency across the industry and the ability of the applicant to ensure that people who hold out that they comply with the code do, in fact, comply with the code.

17.15 It will not be mandatory for an industry participant to be party to a code. This reflects the primacy of the obligations imposed by the Act and the facilitative role to be played by codes.

17.16 Codes may also be developed that establish best practice in areas not covered by the Act, but where industry and consumers consider the adoption by industry participants of consistent procedures and standards will facilitate business and enhance services offered to consumers.

17.17 It is expected that new and revised codes will be developed by industry in consultation with ASIC and with consumer associations. The Government considers that existing industry codes including those relating to practices in the areas of banking, deposit-taking, and general insurance will continue to play an important role in fleshing out best practice standards for compliance with the proposed new regime. These codes will, however, need to be amended to ensure that they align with the requirements and obligations imposed by the Bill.

Powers of Court to make certain orders

17.18 The court is given the power to make such orders as it sees fit in a range of situations (proposed section 1101B). This provision is based on section 1114 of the Corporations Law.

17.19 However, the provision will allow ASIC to make an application to the Court in relation to the contravention of a condition on any of the licensees issued under proposed Chapter 7 (proposed subparagraph 1101B(1)(a)(ii)) or conditions related to declared professional bodies (proposed subparagraph 1101B(1)(a)(iv)).

17.20 Other changes in the provision reflect changes in concepts and terminology throughout proposed Chapter 7. For example, references to 'securities' have been amended to refer to 'financial products' and references to 'securities exchange' and 'SCH' have been replaced by references to 'licensed market' and 'licensed CS facility'.

Provisions relating to records and books

17.21 These provisions replicate provisions currently contained in Part 7.14 of the Corporations Law. They relate to:

- preservation and disposal of records — proposed section 1101C is based on current subsections 1116(1)-(4) of the Corporations Law. Subsection 1116(3) relating to contract notes has been omitted. A regulation making power will allow for exceptions to the general rule (proposed subsection 1101C(4)).

- destruction of records by ASIC — proposed section 1101D is based on current subsection 1116(5).

- concealing etc. of books relating to financial products — proposed section 1101E is based on current section 1117.

- falsification of records — proposed section 1101F is based on current section 1118.

- precautions against falsification of records — proposed section 1101G is based on current section 1119.

17.22 Changes have been made throughout these provisions to reflect changes in concepts and terminology throughout proposed Chapter 7.

Contravention of Chapter 7 does not generally affect the validity of transactions

17.23 A failure to comply with any requirement of Chapter 7 and its regulations will not affect the validity or enforceability of any transaction (proposed subsection 1101H(1)).

17.24 This is subject to any express provision to the contrary in the Act or Regulations including regulations made specifically for this purpose (proposed subsections 1101H(2) and (3)).

Effect of gaming and wagering laws

17.25 Gaming and wagering legislation of a State of Territory in this jurisdiction (as defined in section 9 of the proposed Corporations Act) will not prevent the entering into of, or affect the validity or enforceability of a contract that is a financial product (proposed section 1101I).

17.26 This is significantly wider than the current relevant provisions of the Corporations Law (sections 778 and 1141).

17.27 It should be noted, however, that if appropriate, a product may be excluded by the regulations from the definition of 'financial product'. In a comparable manner, Corporations

Regulation 8.1.01A removes from the definition of 'adjustment agreement' certain transactions which relate to the course or outcomes of a sporting event, which are then left to be regulated under the gaming and wagering legislation.

Delegation

17.28 The Minister will be empowered to delegate any of his powers under proposed Chapter 7 to ASIC, a member of ASIC or a staff member of ASIC who is an SES employee or holds a position equivalent to that of an SES employee (proposed section 1101J).

17.29 This will bring a measure of flexibility and allow the Minister to delegate, for example, the power to disallow the operating rules of the smaller financial markets.

18

Continuous disclosure

18.1 The provisions relating to continuous disclosure currently contained in Part 7.11 of the Corporations Law (sections 1001A and 1001B) will be located in proposed Chapter 6CA. Their placement near Chapter 6D reflects the fact that these provisions deal with ongoing disclosure obligations in relation to securities as defined for the purposes of Chapters 6D and 7. Ongoing disclosure obligations in relation to financial products other than securities will be dealt with in proposed section 1017B. Amendments will be made to correct cross-references in the current provisions.

18.2 In addition to their re-location, the provisions will be amended to take account of changes being made by the FSR Bill as well as the recommendations of the CASAC Report on Continuous Disclosure.

18.3 Contraventions of these provisions will be made financial services civil penalty provisions, in line with the approach being taken to a number of other prohibitions related to market misconduct.

18.4 These proposed amendments are contained in Schedule 2.

Amendments to Part 1.2A — Disclosing Entities

18.5 Subsection 111AE(1) of the proposed Corporations Act will be amended so that if a body is (with its agreement) included in the official list of a prescribed financial market, and that market's listing rules apply according to their terms to the body in relation to a class securities issued by the body, then those securities will be ED securities and that market will be listing market in relation to that body (Item 10 of Schedule 2).

18.6 A significant change from the existing subsection 111AE(1) is that securities no longer have to be actually quoted on a market before the continuous disclosure obligations apply according to the listing rules. This means that it is now possible (depending on an individual market's listing rules) that continuous disclosure may apply when securities are suspended from trading, or after a body is listed but before the securities are actually quoted. This will remove a number of existing anomalies and provide markets with greater flexibility.

18.7 The second significant change is that the continuous disclosure obligations will only apply when a body is included in the official list of a 'prescribed financial market'.

18.8 Proposed subsection 111AE(1A) similarly deals with the application of continuous disclosure to listed managed investment schemes.

18.9 In relation to the application of continuous disclosure under section 111AF (unquoted securities), proposed section 111AFA (Item 15 of Schedule 2) will preserve the existing treatment

of interests in managed investment schemes. This new provision is required as disclosure in relation to such interests will now take place under Part 7.9 rather than Chapter 6D.

18.10 In the same way as current section 713 provides relief for continuously quoted securities, proposed section 1013I will modify the PDS obligations in relation to managed investment products that are subject to continuous disclosure. Amendments will be made to section 713 of the proposed Corporations Act to omit references to managed investment schemes.

Disclosure for listed disclosing entities bound by disclosure requirements in listing rules

18.11 Proposed section 674 (Item 24 of Schedule 2) generally replicates section 1001A of the Corporations Law, subject to changes in terminology. In order to comply with the Criminal Code, the fault elements currently contained in subsections 1001A(2) and (3) have been omitted and the default fault elements under the Code will apply in future to offences against this provision. Proposed section 678 applies the Criminal Code to all offences in Chapter 6CA at commencement.

18.12 Proposed subsection 674(5) requires an operator of a listing market to make provisions of the listing rules that relate to continuous disclosure available to listed disclosing entities. This provision will ensure that listed disclosing entities are aware of their obligations under the listing rules where those obligations could result in criminal liability.

Disclosure for other disclosing entities

18.13 Proposed section 675 is the equivalent of section 1001B of the Corporations Law. However, it would apply not just to unlisted disclosing entities but also to any listed disclosing entity where none of its listing markets has listing rules that contain obligations to continuously disclose information.

18.14 For these bodies, there is an obligation (like section 1001B of the Corporations Law) to lodge a document containing information that is not generally available and that a reasonable person would expect, if it were generally available, to have a material effect on the price or value of ED securities of the body. The information does not have to disclosed if:

- in the case of securities that are not managed investment products, the information doesn't have to be included in a supplementary or replacement disclosure document;
- if the securities are managed investment products, the information has not been included in a PDS or supplementary PDS which has been lodged with ASIC;
- in any case, the information does not have to be disclosed if the regulations provide that it does not have to be.

18.15 It is envisaged that the regulations will provide for exceptions to proposed section 675 that will fulfil the role of the exceptions to proposed section 674 that may be contained in a market's listing rules. These are necessary to prevent the disclosure of commercially damaging information or information whose disclosure would be detrimental to the interests of shareholders or the members of a managed investment scheme.

18.16 Proposed section 676 contains a definition of when information is generally available that is equivalent to the one currently in section 1001C. Similarly, proposed section 675 defines material effect on price or value in the same way as current section 1001D.

Evidential use of information

18.17 Under the Corporations Law, only documents lodged with ASIC are admissible as evidence under subsection 1274(5). Subsection 1274(2A) (documents lodged with ASIC) only covers documents provided by a securities exchange to ASIC under subsection 766(2B).

18.18 It is proposed that subsection 1274(2A) of the proposed Corporations Act will be amended (Items 32 and 33 of Schedule 2) so that any document given to ASIC by a market licensee that contains information that the licensee has made available to participants in the market will be taken to be a document lodged with ASIC for the purposes of subsections 1274(2) and 1274(5). This is in accordance with a recommendation contained in CASAC's *Report on Continuous Disclosure*.

19

Recording of telephone conversations during takeovers

Telephone monitoring during takeovers

19.1 The proposed amendments in Part 2 of Schedule 3 relate to the recording of calls during takeovers. The provisions will be inserted as Subdivision D in Division 5 of Part 6.5 of the proposed Corporations Act.

19.2 The general requirement (proposed section 648J) will to be to require a bidder or target (referred to in the provisions as the recorder) to make a clear sound recording of all telephone calls that the recorder makes during a bid period to holders of securities in the bid class or to holders of securities that come to be in the bid class due to conversion of or exercise of rights attached to other securities, provided the bid extends to these securities. This obligation will extend to all telephone calls made for the purpose of discussing the takeover bid, even if they were also made for another purpose. The obligation does not extend to calls made by holders of the securities to the bidder or target or to other forms of communication.

19.3 This requirement will ensure that there will be record of the conversation if bidders or targets contact the holders of bid class securities during takeovers. In the event that either the holder of the securities or ASIC wishes to investigate what was said in the conversation, for example, to determine whether any of the statements made could amount to misleading or deceptive conduct, this would facilitate the investigation and any enforcement action that might result from it. In the absence of such recordings, it would be difficult to prove that particular statements were made. This could prevent the effective enforcement of provisions of the proposed Corporations Act that could relate to these calls.

19.4 When a call is recorded there is a requirement for the recorder to notify the other person that the call is being recorded (proposed section 648K). Failure to do this would constitute a contravention by the recorder of the *Telecommunications (Interception) Act 1979.*

19.5 A number of other requirements will apply to the making of these recordings. The recorder will have to identify each recording by indicating on it the parties to the conversation and the date and time when it occurred (proposed section 648L).

19.6 There are also a number of obligations that continue after the recordings are made. These obligations are placed on the recorder or, where the recorder has been wound up, then jointly on the former directors of the recorder (proposed section 648M). This person is referred to as the recording custodian.

19.7 These obligations include keeping and maintaining the index as well as storing the recordings themselves. The recordings must be kept at the place specified in the index. They must

be kept in a manner that protects them from misuse, loss, unauthorised access, modification or disclosure and as prescribed by the regulations (proposed section 648N).

19.8 The recordings and index must be kept by the recording custodian for 12 months and then destroyed. However ASIC may extend this period through a notice in writing to the recording custodian (for example, if it is proposing to undertake an investigation of conduct during the takeover bid).

19.9 Access to the index and recordings is subject to strict controls for privacy reasons (proposed section 648Q). They can only be accessed for the purpose of ensuring compliance with the corporations legislation. Generally, only the parties to the conversation, ASIC or a person authorised by a court can access the recordings and the index. The recording custodian can only give possession of them to another person if they are required to do so by a court order in accordance with Division 3 of Part 3 of the ASIC Act.

19.10 There are prohibitions on a person copying or tampering with the index or recordings or on the recording custodian allowing a person to do such a things (proposed sections 648R and 648S).

19.11 While generally, an index or recording is not a 'book' for the purposes of the proposed Corporations Act, they are 'books' for the purposes of some provisions of the proposed ASIC Act (Item 28 of Schedule 3, Part 1). This ensures that ASIC's powers under Part 3 of the ASIC Act are available in relation to these recordings and indexes.

19.12 Offences related to contraventions of these obligations give rise to offences created through the operation of subsection 1311(1) of the proposed Corporations Act. These offences will be subject to the Criminal Code on commencement (proposed section 648U).

20

Other consequential and miscellaneous amendments

ASIC Act

Bodies established under the ASIC Act

20.1 The Companies and Securities Advisory Committee (CASAC) will be renamed as the Corporations and Markets Advisory Committee (CAMAC). This reflects the wider subject matter that this body will be dealing with under the new regime. Similarly, the Parliamentary Joint Committee on Corporations and Securities will be renamed as the Parliamentary Joint Committee on Corporations and Financial Services so as to better reflect the ambit of the proposed Corporations Act as amended by the FSR Bill.

20.2 Amendments will be made to the criteria for appointments to ASIC, CAMAC and the Takeovers Panel (Items 16, 102, 130 and 131 of Schedule 1, Part 2) so that financial products and services are specifically mentioned. These changes also reflect the extended ambit of the Corporations legislation proposed under the Bill.

20.3 The application of the ASIC Act to external territories will be amended (Item 6 of Schedule 1, Part 2) to allow for the ASIC Act to apply to external territories only in specified circumstances and only in relation to certain provisions. This reflects the amendments to the proposed Corporations Act that allow for the flexible application of proposed Chapter 7 to external territories (discussed below at paragraphs 20.24 and 20.25).

20.4 Where an expression has different meanings in different provisions of the Corporations Act, the meaning for the purposes of Chapter 7 will by default be the meaning of that expression in the ASIC Act (Item 15 of Schedule 1, Part 2).

Consumer Protection in relation to financial products and services - Division 2 of Part 2

20.5 It is proposed that Division 2 of Part 2 will be amended to take into account changes being made to provisions of the proposed Corporations Act. This involves amending the scope of the application of the Division. Exclusions relating to dealing in securities will be amended and revised definitions of financial products and services will be inserted. The new definitions (subject to comments below) reflect the definitions of these terms in proposed Chapter 7.

Application of provisions to 'dealings in securities'

20.6 It is proposed to extend the coverage of the consumer protection provisions contained in section 12DA, section 12DB and Section 12DD of the proposed ASIC Act to certain dealings in securities. Under the current regime, these three sections do not apply in relation to dealings in

securities. The purpose of these limitations is to ensure that dealings in securities are subject to the specific Corporations Law liability regimes governing takeover and fundraising documents.

20.7 It is proposed that these sections of the proposed ASIC Act will apply in relation to dealings in securities in line with proposed subsection 1041K, which will replace section 995A of the proposed Corporations Act. The limitations in sections 12DA and 12DB will be narrowed so that these sections apply to dealings in securities (as defined in Chapter 7) except in relation to conduct that contravenes specific liability regimes contained in section 670A, section 728 and Parts 7.7 and 7.9 of the proposed Corporations Act (Items 21 and 22 of Schedule 1, Part 2).

20.8 It is proposed that subsection 12DD(2) will be amended to clarify that the meaning of securities in that provision is the meaning for the purposes of Chapter 6D of the Corporations Act. This provision has otherwise not been changed, as this exclusion is relevant to takeovers, which apply only in relation to securities (Item 24 of Schedule 1, Part 2).

20.9 It is proposed that section 12DC will be amended to apply in relation to financial products that involve interests in land (it currently only applies in relation to securities). A similar amendment is proposed for section 12DK (Items 23, 25 and 26 of Schedule 1, Part 2).

20.10 It is proposed that Subdivision F of Division 2 of Part 2 will be repealed. Proposed section 1101A in Chapter 7 will perform an equivalent function in the future (Item 27 of Schedule 1, Part 2).

Revised Definition of Financial Product

20.11 Proposed section 12BAA is based on the approach adopted in Division 3 of Part 7.1 of the proposed new Chapter 7 of the Corporations Act (Items 18 and 20 of Schedule 1, Part 2). However the definition of 'financial product' for the purposes of Division 2 of Part 2 of the ASIC Act will be wider than that contained in Chapter 7 of the Corporations Act. This approach is intended to ensure that ASIC rather than the Australian Competition and Consumer Commission (ACCC) has broad responsibility for consumer protection in relation to financial products. It is also intended to ensure that ASIC's consumer protection provisions will apply to financial products that may not be subject to the new licensing, disclosure and conduct framework proposed in Chapter 7 of the proposed Corporations Act.

20.12 A 'financial product' is defined as a facility through which a person makes a financial investment, manages financial risk or makes non-cash payments. The definition of when a person makes a 'non-cash payment' for the purposes of Division 2 of Part 2 of the ASIC Act includes the types of payments that are excluded by proposed subsection 763D(2) of the proposed Corporations Act.

20.13 The list of specific inclusions is broader than that contained in the proposed section 764A of the proposed Corporations Act. It includes all contracts of insurance (other than health insurance provided as part of a health insurance business), all life policies or sinking funds that are not contracts of insurance, all beneficial interests in superannuation funds and all foreign exchange contracts, including contracts to exchange one currency for another that are to be settled immediately through the physical delivery of notes and/or coins in the second currency. This ensures that pure money changing will be subject to the consumer protection provisions of the ASIC Act.

20.14 The list of specific exclusions is narrower than that contained in the proposed section 765A of the Corporations Act. Health insurance provided as part of a health insurance business is specifically excluded from the definition of a 'financial product'. This will ensure that health insurance is regulated by the ACCC rather than ASIC.

Revised Definition of Financial Service

20.15 The Bill inserts a new definition of 'financial service' in place of the definition currently contained in subsection 12BA(1) (Items 19 and 20 of Schedule 1, Part 2). The current definition states that a financial service means a service that 'consists of providing a financial product; or is otherwise supplied in relation to a financial product'.

20.16 Proposed section 12BAB follows the model adopted in Division 4 of Part 7.1 of proposed Chapter 7. It states that a person provides a 'financial service' if they: provide financial product advice; deal in a financial product; make a market for a financial product; operate a registered scheme; provide a custodial or depository service; operate a financial market or clearing and settlement facility; or provide a service that is otherwise supplied in relation to a financial product. A financial product is defined in proposed new section 12BAA. The regulations will be able to modify this definition by prescribing other conduct that constitutes the provision of a 'financial service' for the purposes of Division 2 of Part 2 of the ASIC Act.

Investigations and information-gathering - Part 3

20.17 It is proposed that the ambit of Part 3 of the ASIC Act will be amended in line with the proposed Chapter 7, so provisions that currently apply to securities and futures contracts will apply in relation to all financial products. This will ensure that ASIC's investigation powers apply to all financial products that will be regulated under proposed Chapter 7.

20.18 Other changes in terminology are also reflected in the proposed amendments to Part 3. For example, references to 'securities exchange' will be amended to 'financial market or clearing and settlement facility' (for example, items 36, 37 and 40 of Schedule 1, Part 2), while references to a 'dealer or investment adviser' will be generalised to include anyone carrying on a financial services business (for example, items 38, 44 and 52 of Schedule 1, Part 2).

20.19 Where securities and futures contracts are currently dealt with in separate provisions (for example, sections 31 and 32 of the proposed ASIC Act), the provision relating to futures contracts will be omitted and the one dealing with securities will be amended to cover all financial products (Items 38-39, 41-43 and 45-46 of Schedule 1, Part 2).

20.20 A similar approach will be adopted in relation to sections 41, 43, 44 and 46 (Items 52 to 74 of Schedule 1, Part 2). For sections 73 and 74, the effect of current subsection 74(2) (which ensures that certain rights of futures exchanges and relevant clearing houses are not affected by an order under current subsection 74(1)) will be preserved through the proposed insertion of a new subsection 73(2) (Item 78 of Schedule 1, Part 2).

20.21 It is proposed to amend section 127 of the proposed ASIC Act to increase flexibility by providing that in future the details of situations under other Acts in which disclosure of information is permitted can be set out in regulations. Subsections 127(1B) to (1E) will be omitted (Item 86 of Schedule 1, Part 2) and these situations will be provided for by regulation in the future (Item 91 of Schedule 1, Part 2).

Restrictions on dealings in futures contracts - Division 3 of Part 7

20.22 The proposed amendments to the prohibition on insider trading in proposed Part 7.10 of the proposed Corporations Act will increase the ambit of the prohibition so that it will cover all financial products that are traded on a financial market. This means that the specific prohibition on dealing in futures contracts in Division 3 of Part 7 of the ASIC Act that applied to people who had

gained information as a result of being a member or staff member of ASIC is no longer necessary and will be omitted (Item 94 of Schedule 1, Part 2).

Miscellaneous - Part 15

20.23 It is proposed that section 243D, which provides that despite certain provisions of the *Financial Transactions Reporting Act 1988* certain information may be communicated to a range of people, will be amended to reflect changes in terminology and concepts in Chapter 7 (Item 135 of Schedule 1, Part 2). The amended provision will allow the passing of information to market and clearing and settlement facility licensees and operators of exempt markets and clearing and settlement facilities as well as in accordance with any relevant conditions on such licenses or exemptions.

Corporations Act

Application to External Territories

20.24 The application of the Corporations Act to external territories will be amended (see proposed amendments to section 5 in Items 139-142 of Schedule 1, Part 2) so that, in relation to proposed Chapter 7, regulations will be able to provide that in certain circumstances specified provisions of Chapter 7 will apply to an external territory. The territory will then be in 'this jurisdiction' for the purposes of the Corporations Act. This will extend to parts of Chapters 1 and 9 that apply in relation to those provisions.

20.25 This flexible application is necessary to ensure that the current framework governing the regulation of certain financial products and services in external territories can be continued under the proposed Chapter 7 without having to apply the entire regime to external territories.

Extraterritorial Application

20.26 It is proposed that subsections 5(3) to 5(6) will be amended (Item 140 of Schedule 1, Part 2) to simplify the provisions relating to the application of the proposed Corporations Act to acts and omissions outside of this jurisdiction. As proposed Chapter 7 contains provisions specifically dealing with when the provisions of the Chapter apply to acts and omissions outside of this jurisdiction (in contrast to the current Chapters 7 and 8, which do not contain such provisions), it will be possible to simply state that each provision of the Act applies in this jurisdiction and in relation to acts and omissions outside this jurisdiction according to its tenor.

Application to the Crown

20.27 It is proposed that the application of Chapter 7 to the Crown in a particular capacity will be able to be determined by regulation (Item 143 of Schedule 1, Part 2). Due to the very wide application of proposed Chapter 7 and the rapid rate of change in the financial services industry, it is preferable to do this by regulation rather than in the Act itself in order to provide the necessary flexibility to ensure that the Crown is bound in appropriate circumstances. Regulations binding the Crown in a capacity other than the Commonwealth will, however, only be made at the request or with the concurrence of the relevant State or Territory.

20.28 It is also proposed to amend subsection 5A(5) of the proposed Corporations Act to clarify that nothing in the Act makes the Crown liable to a pecuniary penalty (Item 144 of Schedule 1, Part 2). This is consistent to the approach already taken in relation to offences.

Definitions

20.29 A large number of definitions and related provisions in Chapter 1 are currently required only because of existing Chapters 7 and 8. The proposed repeal of these Chapters means that these definitions are no longer required and they will be omitted.

20.30 A number of new definitions are required for proposed Chapter 7. These are generally contained in proposed Part 7.1 (see particularly proposed section 761A). Where these definitions are required outside Chapter 7, it is proposed to insert references to them in section 9 stating that they have the same meaning outside Chapter 7 as in Chapter 7.

20.31 In addition, a number of existing definitions will require amendment due to changes in terminology.

Prescribed Financial Markets

20.32 It is proposed that a concept of a 'prescribed financial market' (Item 259 of Schedule 1, Part 2) will be introduced to allow for the selective application of some provisions in the Corporations Act to certain financial markets. The most significant example of the proposed use of this concept is in the definition of 'listed' (Item 239 of Schedule 1, Part 2) which will be amended so that a company, for example, will only be regarded as 'listed' if it is included in the official list of a prescribed financial market. This mechanism is necessary to ensure that provisions dealing with listed companies and other bodies to not apply inappropriately to bodies that might otherwise be 'listed'.

20.33 The definition of 'relevant financial market' will be similarly amended so that it only covers prescribed financial markets on which the company or scheme is listed. An analogous definition of 'relevant market operator' will be also be used to refer to the operator of any prescribed financial market on which the company or scheme is listed (Items 270 and 271 of Schedule 1, Part 2).

20.34 Generally, references to 'securities exchanges' in the proposed Corporations Act will be amended to refer to prescribed financial markets or their operators, as appropriate.

20.35 Paragraph 323DA(1)(c) will be amended (Item 355 of Schedule 1, Part 2) to clarify that markets prescribed for the purposes of this paragraph are different to the concept of a 'prescribed financial market' as used elsewhere in the Act.

20.36 A number of provisions in the Corporations Law currently only apply to bodies included in the official list of the Australian Securities Exchange. The equivalent provisions in the proposed Corporations Act will be amended so that they apply to bodies that are included in the official list of a prescribed financial market. This is consistent with the approach of omitting specific references to the Australian Stock Exchange. The proposed mechanism for prescribing certain financial markets will provide sufficient flexibility to ensure that these provisions have appropriate coverage. These amendments are located in Items 341-347, 352, 354, 356 of Schedule 1, Part 2.

Definition of securities

20.37 The current definitions of securities in section 92 of the proposed Corporations Act will generally continue to apply. References relating to the current Chapter 7 in subsection 92(1) of the proposed Corporations Act will be omitted (paragraphs 92(1)(ca) and (e)). However this definition will continue to apply outside of Chapters 6, 6A, 6B, 6C, 6CA, 6D and 7. Similarly, paragraph 92(2)(ca) and subsection 92(2A) are no longer relevant as they relate to the current Chapter 7 and will be omitted.

20.38 The subsection 92(3) definition will be amended to apply in relation to Chapters 6, 6A, 6B, 6C and 6CA. The definition of 'security' in proposed section 761A will apply to Chapter 6D and proposed Chapter 7.

20.39 As a result of this change in the definition of securities for the purpose of Chapter 6D, disclosure for managed investment products will occur under proposed Part 7.9. Therefore, it is proposed to make consequential amendments to remove references to managed investment schemes from Chapter 6D (Items 410, 414, 423 and 427 of Schedule 1, Part 2).

20.40 In subsections 92(1), (2) and (3), the exclusion of 'futures contracts' will be omitted (as the concept will no longer exist) and will be replaced by an exclusion for derivatives. Options to acquire securities by way of transfer will, however, not be excluded. It is unnecessary to state that options to acquire securities by way of issue are not excluded as they are not included in the definition of 'derivative' (see discussion relating to definition of 'derivative' at paragraphs 6.72 and 6.73 and the note to proposed subsection 92(1)).

20.41 The relevant amendments are in Items 315-327 of Schedule 1, Part 2.

Other Consequential Amendments

20.42 References in Chapter 6 of the proposed Corporations Act to 'the provision of financial services' will be omitted and replaced by the expression 'the provision of financial accommodation by any means'. This will retain the current effect of these provisions while removing any possible confusion that could otherwise arise from the use of 'financial services' in a context where it is not intended to refer to the meaning of this expression in proposed Chapter 7 (Items 363 and 369 of Schedule 1, Part 2).

20.43 Chapter 6 of the Corporations Law contains a number of provisions that refer to the SCH business rules and SCH sub-register. In accordance with the changes being made by the Bill, these references will be omitted from the equivalent provisions in the proposed Corporations Act and regulation making powers will be provided instead (Items 390-392, 395, 396 and 398 of Schedule 1, Part 2).

Amendments related to previous changes to the Corporations Law

20.44 Part 1 of Schedule 3 contains proposed amendments to the proposed Corporations Act to remove a number of current anomalies in the Corporations Law that resulted from amendments made by the *Managed Investments Act 1998* and the CLERP Act.

Definition of associate

20.45 It is proposed to omit the definition of 'associate' in section 9 of proposed Corporations Act (that was inserted into the Corporations Law by the CLERP Act) and in section 12 (which is redundant following the CLERP Act reforms). A replacement definition of 'associate' will be inserted in place of the section 12 definition (Item 15 of Schedule 3, Part 1).

20.46 This new definition will clarify that the narrower meaning of the term 'associate' as currently defined in section 9 will apply to all instances of 'associate' in Chapters 6, 6A, 6B and 6C. Under the current arrangements, it is not always clear when the narrower definition of 'associate'

should be used and when the ordinary definition should apply. References to section 12 in section 13 of the proposed Corporations Act will be omitted (Item 16 of Schedule 3, Part 1).

20.47 In addition, it is proposed that the exemptions in section 16 should also apply to the proposed definition in section 12. These exemptions do not currently apply to the section 9 definition.

20.48 Proposed subsection 12(2) will also clarify that where associate is used in another definition (such as the definition of substantial holding in section 9), and that other definition is used in a provision in Chapters 6 to 6C, then associate has the narrower section 12 meaning.

Definition of continuously quoted securities

20.49 It is proposed to replace paragraph (b) of the definition of 'continuously quoted securities' in section 9 of the proposed Corporations Act (Item 9 of Schedule 3, Part 1). The purpose of the new paragraph (b) is to ensure that the securities of an entity that is covered by an order under section 340 or 341 of the proposed Corporations Act (that allows ASIC to make orders exempting directors, companies, schemes, entities or auditors from the provisions of the Act governing financial reports and audit) does not fall within the definition of 'continuously quoted securities' for the purposes of the fundraising provisions contained in Chapter 6D. This will ensure that entities that have been exempted from the Act's requirements relating to financial reports and audit do not benefit from the reduced disclosure obligations that are available under Chapter 6D in relation to 'continuously quoted securities'.

Definition of qualified accountant

20.50 It is proposed to amend the definition of 'qualified accountant' in section 9 of the proposed Corporations Act (Items 12 and 17 of Schedule 3, Part 1). The definition currently refers to 'a member of a professional body that has been approved by ASIC in writing for the purposes of this definition'.

20.51 The purpose of the amendment is to refine ASIC's powers so that it can declare in writing that either all members of a specified professional body, or that only persons in a specified class of members of a specified professional body, are qualified accountants. It will also clarify ASIC's power to revoke such a declaration. Proposed subsection 88B(4) will ensure that existing approvals will remain in place as if they were approvals under the new arrangements.

Definition of substantial holding

20.52 It is proposed to amend the definition of 'substantial holding' contained in section 9 of the proposed Corporations Act to replace 'takeover period' with 'bid period' (Item 14 of Schedule 3, Part 1). This change is necessary, as the term 'takeover period' is not defined in the Act.

Off-market takeover bids — consideration offered

20.53 Subsection 650B(1) of the proposed Corporations Act allows a bidder to vary offers made under an off-market bid by improving the consideration offered. Subsection 650B(2) states that a target shareholder that has already accepted an offer is entitled to receive the improved consideration immediately (or immediately after the exercise of a fresh election where the improvement consists of adding a new form of consideration or any other improvement not listed in items 1 to 3 of subsection 650B(2)).

20.54 It is proposed to amend subsection 650B(2) of the proposed Corporations Act to ensure that the bidder will not become liable to pay or provide consideration under the bid earlier than would

otherwise be the case as a result of improving the consideration offered under the bid (Item 22 of Schedule 3, Part 1).

General compulsory acquisitions and buy-outs

20.55 Part 6A.2 of the proposed Corporations Act sets out provisions governing compulsory acquisition of outstanding classes of securities by a 90 per cent holder (in circumstances other than following a successful takeover bid). Section 664B currently stipulates that a 90 per cent holder may only acquire outstanding securities in the class for a cash sum and must pay the same amount for each security in the class acquired.

20.56 Section 664B of the current Corporations Law will be amended to enable a 90 per cent holder to pay different amounts where these differences are attributable to either differences in the accrued dividend or distribution entitlement of the securities of differences in the amounts paid up or remaining unpaid on the securities (Items 24 and 25 of Schedule 3, Part 1). The purpose of the amendment is to ensure that consideration paid for outstanding securities can be appropriately varied to reflect variations in the value of different securities within the class.

Obligations in relation to preparation of expert reports

20.57 Subsections 670C(2) and 670C(3) of the existing Corporations Law require experts whose reports accompany or are included in takeover or compulsory acquisition documents to notify the issuer of the document in writing as soon as practicable if they become aware of a defect in the report (either a material statement that is misleading or deceptive or a significant change affecting information included in the report) during the 'takeover period'. However, the term 'takeover period' is no longer defined in the Corporations Law. It is therefore proposed to replace 'takeover period' with 'bid period or objection period' in subsections 670C(2) and 670C(3) of the proposed Corporations Act (Item 26 of Schedule 3, Part 1).

Fundraising – offers that do not need disclosure

20.58 Section 708 of the Corporations Law lists various types of offers of securities that do not require disclosure under Chapter 6D. This section is intended to apply to all bodies. However it currently includes some references to 'company'. It is therefore proposed to replace references to 'company' in paragraph 708(13)(a) of the proposed Corporations Act with references to 'body' (Item 27 of Schedule 3, Part 1).

Renaming of Corporations and Securities Panel

20.59 The 'Corporations and Securities Panel' will be renamed as the 'Takeovers Panel'. The role of the Panel is to provide a mechanism for the peer review of takeover activity, with the aim of being more expeditious and less formal than the courts. The role of the Panel was reformed under the CLERP Act.

20.60 The name Takeovers Panel will more accurately reflect the role and nature of the Panel's work. Therefore, it is proposed that amendments will be made to references to the Corporations and Securities Panel in both the proposed Corporations Act and ASIC Act (Items 1-4, 11, 20 and 23 of Schedule 3, Part 1).