

FINANCIAL SECTOR REFORM UPDATER SERVICE

Service Update No. 4

INTRODUCTION

The *Financial Services Reform Act 2001* (FSRA), which commenced on 11 March 2002, introduced a uniform licensing, conduct and disclosure regime for financial service providers. A two-year transition period was established under the FSRA to allow time for existing industry participants, including lawyers, accountants and tax professionals (“professionals”), to enter the new regime. The operative sections of the FSRA are now found in various statutes, predominantly the Corporations Act (“Act”),

If a person provides a *financial service* within the meaning of the Act, then that person needs to become licensed to operate under the FSRA. Various exemptions from the impact of FSRA are found in the Act and the Corporations Regulations (“Regulations”). The objective of this update is to summarise in one place:

- the key sections of the Act that impose an obligation on professionals to obtain an AFS licence and
- the exceptions to the FSR regime available to these professionals.

This summary is prompted by the fact that despite intensive lobbying by the various professional bodies over the past six months, the professions have not been entirely excluded from this new regime. The update will conclude with an analysis of the a new regulation that the professional bodies had hoped would largely exclude the professions from the scope of the FSRA.

CORPORATIONS ACT SECTION S763A

General definition of financial product

- 1) For the purposes of this Chapter, a financial product is a facility through which, or through the acquisition of which, a person does one or more of the following:
 - (a) Makes a financial investment
 - (b) Manages a financial risk
 - (c) Makes a non-cash payment

Refer sections:

762C which provides a definition of the term facility

764A which provides details of specific things that are financial products

765A which provides details of specific things that are not financial products

CORPORATIONS ACT SECTION S766A

When does a person provide a financial service

- (1) For the purposes of this Chapter, subject to paragraph (2)(b), a person provides a financial services if they:
 - (a) Provide financial product advice
 - (b) Deal in financial product
 - (c) Make a market for a financial product
 - (d) Operate a registered scheme
 - (e) Provide a custodial or depository service
 - (f) Engage in conduct of a kind prescribed by regulations made for the purposes of this paragraph

CORPORATIONS ACT SECTION S766B

Meaning of financial product advice

- (1) For the purposes of this Chapter, financial product advice means a recommendation or a statement of opinion, or a report of either of those things, that:
 - (a) is intended to influence a person or persons in making a decision in relation to a particular financial product or class of financial products, or an interest in a particular financial product or class of financial products; or
 - (b) could reasonably be regarded as being intended to have such an influence.

However, the provision or giving of an exempt document or statement is not to be taken to be a provision of financial product advice.

CORPORATIONS ACT SECTION S766C

Meaning of dealing

- (1) For the purposes of this Chapter, the following conduct (whether engaged in as principal or agent) constitutes dealing in a financial product:
 - (a) applying for or acquiring a financial product;
 - (b) issuing a financial product;
 - (c) in relation to securities or managed investment interests-underwriting the securities or interests;
 - (d) varying a financial product;
 - (e) disposing of a financial product.
- (2) *Arranging* for a person to engage in conduct referred to in subsection (1) is also dealing in a financial product, unless the actions concerned amount to providing financial product advice.

The term arranging is not defined in the Act, however ASIC has said in LIC 60¹ that arranging refers to the process by which a person negotiates for, or brings into effect, a dealing in a financial product. ASIC goes on to say that the following conduct may constitute arranging:

- *where involvement in the chain of events leading to the relevant dealing is of sufficient importance that, without that involvement, the transaction would probably not take place (for example: where an individual is the main or only person consumers deal directly with in a particular transaction);*
- *where an individual's involvement significantly "adds value" for a second person;*
- *where benefits are received depending on the decisions made by a second person.*
- *where a service provider takes steps to bring into effect an acquisition or disposal of a financial product albeit another intermediary is also involved in the process and executes the customer's order (for example: where a lawyer refers a client to a licensee in circumstances where the licensee is no more than an order taker).*

CORPORATIONS ACT SECTION 766E

Meaning of provide a custodial or depository service

- (1) For the purposes of this Chapter, a person (the *provider*) provides a *custodial or depository service* to another person (the *client*) if, under an arrangement between the provider and the client, or between the provider and another person with whom the client has an arrangement, (whether

¹ at para 2.3

or not there are also other parties to any such arrangement), a financial product, or a beneficial interest in a financial product, is held by the provider in trust for, or on behalf of, the client or another person nominated by the client.

One reading of this section of the Act is that if the holding of the relevant financial product is in whole or in part a business carried on by an accountant, lawyer or trustee, the following activities will require an AFS licence:

- *holding documents such as share certificates, bank bills or life policies in safe custody for a client;*
- *a trustee of any trust holding any kind of "financial product" on trust for beneficiaries.*

Various exemptions from this requirement are set out in s 766E(3) however none of these appear relevant to the provision of safe custody services by professionals or the trustee of a family trust acquiring financial products. If anything, the existence of the exemptions in s. 766E(3)(c) reinforces the concern that the definition in s. 766E(1) has as wide an impact as suggested above.

CORPORATIONS ACT SECTION 766B(5)

The following advice is **not financial product advice**:

- (a) advice given by a lawyer in his or her professional capacity, about matters of law, legal interpretation or the application of the law to any facts
- (b) except as may be prescribed by the regulations – any other advice given by a lawyer in the ordinary course of activities as a lawyer that is reasonably regarded as a necessary part of those activities
- (c) except as may be prescribed by the regulations – advice given by a *tax agent* registered under Part VIIA of the Income Tax Assessment Act 1936, that is given in the ordinary course of activities as such an agent and that is reasonably regarded as a necessary part of those activities.

While the Act specifically provides that an employee or director of a licensee can provide a financial service² (and similar but restricted provisions can apply to employees of some representatives) neither the Act nor the Regulations provide that an employee of a registered tax agent (or a director of a company that holds tax agent registration) can rely on the tax agent exemption.

In my opinion the exemption in favour of tax agents is restricted to matters to do with the statutory duties of a Registered Tax Agent as set out in section 215L of the ITAA 36. That is:

- *preparation and lodgment of a taxpayer's taxation return and related documents*
- *giving advice about a taxation law;*
- *preparing and lodging objections*
- *reviewing or appealing tax decisions;*
- *dealing with the Commissioner on behalf of a taxpayer.*

*If this is correct, then the tax agent exemption will be of little assistance when a tax agent provides value added services such as giving advice as to the best business structure to adopt or advice in regard to managing financial risk and making non cash payments. **However** further exemptions, in regard to taxation matters can now be found in the new regulation 7.1.29.*

² S. 911(B)(1)

CORPORATIONS REGULATION 7.1.29

The Corporations Amendment Regulations 2003 (No. 3) received Royal Assent on 1 May 2003 and came into effect upon being gazetted on 3 May 2003. The most important part of these new regulations from the perspective of the professions is that they repeal and replace regulation 7.1.29. The new regulation is reproduced below. The commentary on regulation 7.1.29 is provided below.

Circumstances in which a person is taken not to provide a financial <u>service</u>	Comments
<p>(1) For paragraph 766A (2) (b) of the Act, a person who provides an eligible service is taken not to provide a financial service if:</p> <p>(a) the person provides the eligible service in the course of conducting an exempt service; and</p> <p>(b) it is reasonably necessary to provide the eligible service in order to conduct the exempt service; and</p> <p>(c) the eligible service is provided as an integral part of the exempt service.</p>	<p>The intention is that this financial service must be an integral and not merely incidental part of the specified activity to take advantage of this licensing exemption. This should be contrasted with the “merely incidental” exemption available to some professionals under the old regime.</p> <p>The following questions exist:</p> <ul style="list-style-type: none"> • will it be reasonably necessary for an accountant to provide a dealing service as part of advising on establishing a shelf company when appropriately licensed persons are conveniently available to provide this service. • will arranging the transfer of financial products between members of a group be an “integral” part of advising on a restructure if the transfer is not completed until several months after the advice is given, or the restructure completed. • Does this exemption extend to undertaking dealing activities after giving advice in regard to a merger or acquisition of a small proprietary company? If so, does it extend to similar activities for a listed public company?
<p>(2) For this regulation, a person provides an eligible service if the person engages in conduct mentioned in paragraphs 766A (1) (a) to (f) of the Act.</p>	<p>An 'eligible service' has the same meaning as a financial service under subsection 766A(1) of the Act.</p>
<p>(3) For this regulation, a person who does any of the following provides an exempt service:</p> <p>(a) provides advice in relation to the preparation or auditing of financial reports or audit reports;</p> <p>(b) provides advice on the risk associated with carrying on a business and identifies generic financial products or generic classes of financial product that will mitigate that risk, other than advice for inclusion in an exempt document or statement;</p>	<p>Subregulation (3)(b) is welcome and should be read in conjunction with Regulation 7.1.33A (see below). However it does not allow a professional to recommend that a non-business client should investigate the merits of risk management products such as income protection insurance or splitting their superannuation investments between two or more fund managers. Practitioners must also be careful to ensure that the generic advice that they give does not specifically identify a particular financial</p>

<p>(c) provides advice on the acquisition or disposal, administration, due diligence, establishment, structuring or valuation of an incorporated or unincorporated entity, if the advice:</p> <ul style="list-style-type: none"> (i) is given to a person who is, or is likely to become, an interested party in the entity; and (ii) to the extent that it is financial product advice — is confined to advice on a decision about: <ul style="list-style-type: none"> (A) securities of a body corporate, or related body corporate, that carries on or may carry on the business of the entity; or (B) interests in a trust (other than a superannuation fund or a managed investment scheme that is registered or required to be registered), the trustee of which carries on or may carry on the business of the entity in the capacity of trustee; and (iii) does not relate to other financial products that the body corporate or the trustee of the trust may acquire or dispose of; and (iv) is not advice for inclusion in an exempt document or statement; <p>(d) provides advice on financial products that are:</p> <ul style="list-style-type: none"> (i) securities in a company (other than securities that are to be offered under a disclosure document under Chapter 6D of the Act); or (ii) interests in a trust (other than a superannuation fund or a managed investment scheme that is registered or required to be registered); <p>if the company or trust is not carrying on a business and has not, at any time, carried on a business;</p> <p>(e) provides advice in relation to the transfer of financial products between related bodies corporate;</p>	<p>product.</p> <p>Subregulation 3(c) allows professionals to give advice in regard to mergers and acquisition activities. However, the EM provides that: “The advice must only be in relation to the actual entity carrying on the business, or related entities such as subsidiaries. It will not apply to any financial products that the company acquires or disposes of, such as investments that the company holds.”</p> <p>While the EM is not the law, if this statement is correct then this subregulation will not allow a professional to give a client who is making a takeover bid (or the purchaser of a small business who acquires the shares in a company that owns the business) advice in regard to financial products owned by the takeover target.</p> <p>This regulation also ignores situations where a professional is asked for advice by a purchaser of a company in regard to matters such as:</p> <ul style="list-style-type: none"> • the adequacy of performance bonds provided to secure warranties given by vendors and other related parties; • whether the target entity has appropriate insurance policies in place to manage the business risks the purchaser is about to assume; • whether financial products owned by the target entity (eg: shares in a subsidiary, or cash deposits) should be disposed of, or the terms varied, prior to acquisition. For example, a professional might advise that certain financial products in a company that are of limited value to the purchaser be distributed in-specie to the original shareholders before the takeover is completed so as to reduce the purchase price. Alternatively, it might be necessary to sell off a subsidiary entity prior to completing the take-over because obtaining control of that subsidiary might trigger an event of default under a loan covenant. <p>Subregulation 3(d) provides for the creation of shelf companies and shelf trusts. An interesting thing about this regulation is that, contrary to the view of some commentators; the regulation recognizes that the FSRA extends to trusts.</p> <p>The EM explains that subregulation 3(e) has been allowed “because there is largely limited or no change in beneficial ownership of the financial products involved, such as insurance.”</p> <p>Noticeably, the exemption does not extend to natural persons, related trusts or dealings between entities that have common shareholding but not a common holding company. Nor does it assist in situations such as where financial products are transferred between spouses as a result of a breakdown of a marriage, or transfers between unrelated entities as part of a commercial settlement of a dispute.</p>
--	--

<p>(f) arranges for another person to engage in conduct referred to in subsection 766C (1) in relation to interests in a self managed superannuation fund in the circumstances in paragraphs (5) (b) and (c);</p> <p>(g) arranges for another person to engage in conduct referred to in subsection 766C (1), by preparing a document of registration or transfer in order to complete administrative tasks on instructions from the person;</p> <p>(h) provides advice about the provision of financial products as security, other than where the security is provided for the acquisition of other financial products.</p> <p>(4) For this regulation, a person also provides an exempt service if:</p> <p>(a) the person provides advice to another person on taxation issues including advice in relation to the taxation implications of financial products; and</p> <p>(b) the person will not receive a benefit (other than from the person advised or an associate of the person advised) as a result of the person advised acquiring a financial product mentioned in the advice, or a financial product that falls within a class of financial products mentioned in the advice; and</p> <p>(c) either:</p> <p>(i) the advice does not constitute financial product advice to a retail client; or</p> <p>(ii) the advice constitutes financial product advice to a retail client and it includes, or is accompanied by, a written statement that:</p> <p>(A) the person providing the advice is not licensed to provide financial product advice under the Act; and</p>	<p>Section 766C(1) refers to dealing activities, however despite a statement to the contrary in the EM, arguably this exemption does not extend to <i>arranging</i> a dealing activity because <i>arranging</i> is referred to in section 766C(2). The EM points out that this exemption only extends to providing administrative assistance where the client has already [independently] made the decision to roll over funds into a SMSF.</p> <p>The wording of subregulation 3(g) is curious. Subject to the first point made above in regard to subregulation 3(f), this subregulation allows a practitioner to assist another person undertake a dealing activity (such as allotting shares in a small proprietary company, open a bank account, or increase the level of cover under an insurance policy) however it does not allow that practitioner to actually do any of these tasks on behalf of that client, or as the client’s agent. Another area of concern is that the EM says “This exemption can only be used provided the administrative tasks are due to a direct instruction from the client.” I take this to mean that practitioners require explicit instructions from a client before they can rely on the exemption. If this is correct, practitioners should ensure that they receive written instructions.</p> <p>The EM points out that subregulation 3(h) “cannot be used as a means to provide unlicensed advice when the security is used to purchase other financial products, such as margin loans”. However, as worded this subregulation does not extend to giving advice in regard to giving a charge to secure a loan that will be used to:</p> <ul style="list-style-type: none"> • invest in subsidiary by purchasing shares in that subsidiary; • make payments into a superannuation fund (perhaps borrow to finance a Superannuation Guarantee obligation); • pay insurance premiums (such as insurance premium funding). <p>Two points need to be made about subregulation 4.</p> <ul style="list-style-type: none"> • Despite the green light given to the payment of referral fees and commissions under the FSRA regime (see regulation 7.6.01(1)(e) below), the 7.1.29(4) concession does not apply if a referral fee or commission is accepted by the practitioner. • Given the frequency with which tax practitioners give advice about tax matters that will include “incidental” advice about financial products it appears that it will be prudent to have the warning set out in subregulation (4)(c)(ii) printed on all our stationary and on a pad, similar to “sick certificates” used by a GP, that we can hand out to clients at the end of a tax consultation.
---	--

<p>(B) taxation is only one of the matters that must be considered when making a decision on a financial product; and</p> <p>(C) the client should consider taking advice from the holder of an Australian Financial Services Licence before making a decision on a financial product.</p> <p>(5) For this regulation, a person also provides an exempt service if:</p> <p>(a) the person provides advice in relation to the establishment, operation, structuring or valuation of a superannuation fund, other than advice for inclusion in an exempt document or statement; and</p> <p>(b) the person advised is, or is likely to become:</p> <ul style="list-style-type: none"> (i) a trustee; or (ii) a director of a trustee; or (iii) an employer sponsor; or (iv) a person who controls the management; of the superannuation fund; and <p>(c) except for advice that is given for the sole purpose, and only to the extent reasonably necessary for the purpose, of ensuring compliance by the person advised with the SIS Act (other than paragraph 52 (2) (f)), the SIS Regulations (other than regulation 4.09) or the <i>Superannuation Guarantee (Administration) Act 1992</i> — the advice:</p> <ul style="list-style-type: none"> (i) does not relate to the acquisition or disposal by the superannuation fund of specific financial products or classes of financial products; and (ii) does not include a recommendation that a person acquire or dispose of a superannuation product; and (iii) does not include a recommendation in relation to a person's existing holding in a superannuation product to modify an investment strategy or a contribution level; and <p>(d) if the advice constitutes financial product advice provided to a retail client — the advice includes, or is accompanied by, a written statement that:</p> <ul style="list-style-type: none"> (i) the person providing the advice is not licensed to provide financial product advice under the Act; and (ii) the client should consider taking advice from the holder of an Australian Financial Services Licence before making a decision on a financial product. 	<p>Subregulation 5 is the issue that will cause accountants most angst. This subregulation provides that unlicensed advice may be provided to the management or controllers of a superannuation fund in relation to running a superannuation fund. This would include advising a trustee on administration and operational issues.</p> <p>However, the EM specifically states that subregulation (5) does not extend to unlicensed practitioner give advice:</p> <ul style="list-style-type: none"> • in regard to which superannuation structure, vehicle or fund type the person advised should enter; • recommending a person establish a SMSF structure; • recommending a SMSF structure in isolation or as a preferred structure to other alternative investment vehicles. • that a client make additional and voluntary contributions to a superannuation fund; • that a person become a member of a superannuation fund; • that an existing member of the superannuation fund joining another sub-plan in that same fund; • that a superannuation fund change from the growth phase to the pension phase; • that a client transfer between investment options; • in regard to what financial products should be held by a superannuation fund. <p>Therefore, this subregulation only allows a practitioner to advise a superannuation trustee on operational issues such as:</p> <ul style="list-style-type: none"> • how to establish a fund after the trustee has made that decision; • the addition of new trustees and members; and • providing a valuation of the superannuation fund. <p>And under certain circumstance advice on the following issues would be allowed:</p> <ul style="list-style-type: none"> • the sale of financial products to correct a breach under section 129 of SIS; • meeting in-house asset rules; and • modifying the contribution level due to changes in the superannuation guarantee level.
--	---

<p>(6) In this regulation:</p> <p>employer sponsor has the meaning given by subsection 16 (1) of the SIS Act.</p> <p>exempt document or statement has the meaning given by subsection 766B (9) of the Act.</p> <p>generic means without reference to a particular brand or product issuer.</p> <p>interested party means: (a) an associate within the meaning of Division 2 of Part 1.2 of the Act; or (b) a manager; or (c) an officer; or (d) a trustee or director of a trustee.</p> <p>self managed superannuation fund has the meaning given by section 17A of the SIS Act.</p>	
---	--

CORPORATIONS REGULATION 7.6.01

Mere referral

- (1) (e) a financial service provided by a person (*person 1*) in the following circumstances:
- (i) the service consists only of:
 - (A) informing a person (*person 2*) that a financial services licensee is able to provide a particular financial service, or a class of financial services; and
 - (B) giving person 2 information about how person 2 may contact the financial services licensee;
 - (ii) person 1 is not a representative of the financial service licensee, or of a related body corporate of the financial services licensee;
 - (iii) the service is provided by person 1 as an incidental part of person 1's ordinary activities;
 - (iv) person 1 discloses to person 2, when the service is provided:
 - (A) any benefits (including commission) that person 1, or an associate of person 1, may receive in respect of the service; and
 - (B) any benefits (including commission) that person 1, or an associate of person 1, may receive that are attributable to the service;
 - (v) the disclosure mentioned in subparagraph (iv) is provided in the same form as the information mentioned in subparagraph (i);
- (1) (ea) a financial service provided by a person (*person 1*) in the following circumstances:
- (i) the service consists only of:
 - (A) informing a person (*person 2*) that a financial services licensee, or a representative of the financial services licensee, is able to provide a particular financial service, or a class of financial services; and
 - (B) giving person 2 information about how person 2 may contact the financial services licensee or representative;
 - (ii) person 1 is a representative of the financial service licensee, or of a related body corporate of the financial services licensee;
 - (iii) the service is provided by person 1 as an incidental part of person 1's ordinary activities;

One reading of regulations 7.6.01 (e) and 7.6.01(ea) is that a lawyer or accountant who makes a referral to a licensee can do no more than advise the client that the licensee is able to provide certain financial services and provide the licensee's contact details. Refer also to Regulation 7.7.12 which discuss an Authorised Representative's obligations in regard to disclosure when commission is paid.

CORPORATIONS REGULATION 7.1.33A

Allocation of funds available for investment

For paragraph 766A (2) (b) of the Act, a circumstance in which a person is taken not to provide a financial service within the meaning of paragraph 766A (1) (a) of the Act, is the provision of a service that consists only of a recommendation or statement of opinion provided to a person about the allocation of the person's funds that are available for investment among 1 or more of the following:

- (a) shares
- (b) debentures
- (c) debentures, stocks or bonds issued, or proposed to be issued, by a government
- (d) deposit products
- (e) managed investment products
- (f) investment life insurance products
- (g) superannuation products
- (h) other types of asset.