Chapter 2

Summary of main provisions

Financial services regulation

2.1 One of the primary objectives of the bill is to reduce the regulatory burden on providers of financial services, increase access to financial advice and make improvements to various other aspects of the financial services regulatory framework.

Statements of Advice

2.2 In general, a statement of advice (SoA) must be provided where a person seeks financial advice. Some financial advisers provide a free initial consultation at which general investment options may be discussed but no specific products are recommended. Such discussions would generally constitute the provision of personal advice under the Corporations Act, invoking a requirement on the part of the adviser to provide a SoA to the client. The rigorous requirement to produce a SoA under these circumstances potentially distorts the provision of client focused advice. For example, advisers may consider that the cost of producing a SoA is not economic in relation to a free initial consultation where a client has a relatively small amount of money to invest. Where a financial adviser recommends that a person continue to hold an existing product, such advice may constitute personal advice even if the client is advised to take no action and the adviser receives no additional remuneration. This may result in consumers being unable to access general strategic financial advice.

2.3 The bill provides an exemption to the requirement to supply a SoA in two circumstances. The first is where there is no recommendation to buy or sell in relation to a particular financial product, and no remuneration to the provider of the advice. The second is where the amount to which the advice relates is under a prescribed threshold of $15,000 the amount at which it becomes commercially viable for an adviser to provide advice, based on recovering the cost of preparing a SoA. This measure is directed at consumers who wish to obtain financial advice in relation to a relatively small investment amount and are unable to access or afford it because of its relatively high cost.

2.4 The bill will limit the application of the exemption in relation to superannuation advice. Where the aim of advice is to consolidate or supplement a superannuation fund of which the person is an existing member, the exemption will apply. Similar arrangements will apply to advice regarding retirement savings accounts. However, when a SoA is dispensed with a Record of Advice (RoA) must be kept, which will disclose information relating to remuneration, interests and associations of the adviser.

Financial Services Guide

2.5 Where advice is given to a client, the advisor would normally be expected to provide the client with a Financial Services Guide (FSG) that describes the services the licensee provides, information about remuneration and certain other matters. An existing provision exempts the advising entity from supplying a FSG if the general advice is provided in a public forum.[1]

2.6 The bill aims to resolve this lack of clarity by providing that a FSG will not be required at a forum where ten or more retail clients attend, whether or not it is open to any person to attend the forum.

Retail/wholesale client distinction

2.7 The Corporations Act[2] provides that a financial product or service is provided to a client in a retail capacity except in certain circumstances, and contains a number of tests to determine whether a client is considered retail or wholesale. For example, when dealing in financial products (other than general insurance, superannuation and retirement savings account products), if the individual provides evidence that they have net assets of at least $2.5 million or gross income in the last two financial years of at least $250,000 a year, then they may be considered wholesale investors.[3]

2.8 Although existing tests adequately address the circumstances of many investors, there are some investors who are defined in the legislation as retail investors and are unable to access wholesale status. For reasons such as experience or professional training, these investors may wish to be treated as wholesale investors. Such investors may consider retail disclosure an unnecessary hindrance to activities they well understand and would prefer to access wholesale investor status. They may also wish to access wholesale-only products.

2.9 The bill makes provision for an adviser to certify certain clients as wholesale investors, exempting them from additional disclosure requirements. An investor may be treated as a wholesale client if they satisfy an adviser that they are adequately experienced to be considered a wholesale investor. The licensee would have to document the reasons for his conclusion. The investor would need to acknowledge the effect of being treated as a wholesale client.

Cross-endorsement

2.10 Authorised advisers may act for a number of financial services licensees. However, each licensee must consent to the agent being the authorised representative of each of the other licensees. This is commonly referred to as cross-endorsement.

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1 subsection 941C(4).

2 subsection 761G(1)

3 paragraph 761G(7)(c) and Corporations Regulation 7.1.28

2.11 The cross-endorsement arrangements expose the endorsing licensees to joint responsibility for the activities of cross-endorsed authorised advisers that are authorised to provide the same class of financial service. One class of financial service is advice in relation to general insurance.

2.12 Accordingly, two or more licensees may be responsible for advice provided by an agent, even if the advice relates to a type of general insurance that the agent only handles on behalf of one of the two issuers. This means that, for example, an authorised representative of Licensee A who only handles motor vehicle insurance could expose Licensee A to liability in respect of, say, conduct in relation to advice on travel insurance products offered by the authorised representative on behalf of Licensee B.

Product Disclosure Statement notices

2.13 The bill includes a revised approach for lodging 'in use' notices with ASIC. The approach is an on-line reporting mechanism for product issuers to advise ASIC of matters relating to Product Disclosure Statement (PDS) distribution.

2.14 Product Disclosure Statements contain key information regarding a financial product sold to investors. For most classes of financial product, the Corporations Act requires the product issuer to lodge an 'in use' notice with ASIC within five business days of the first use of the PDS.[4] This requirement ensures ASIC is aware of all products being promoted in the market.

2.15 ASIC received approximately 12,000 in use notices in 2004. However, due to the current manual lodgement mechanism, the notice does not fully serve its regulatory purpose as it does not provide adequate means to determine when a PDS is no longer current, for example when it is out of date and/or when a product is withdrawn from the market.

2.16 The bill requires the person responsible for the PDS to lodge a notice with ASIC within five business days of:

- the first use of the PDS;
- a change to the fees and charges set out in the document; and
- cessation of the use of the document.

2.17 The bill allows the notice to be lodged electronically, commencing 1 July 2008. It requires that it be lodged electronically from 1 January 2009.

ASIC and conflict of interest

2.18 This provision is designed to remedy perceived conflicts of interest between market operators acting as both regulator of a market, and controller of interests in

4 section 1015D

companies which they oversee. The bill provides for the market operator's responsibilities in relation to market oversight to revert to ASIC insofar as a conflict of interest may exist between the operator and its interest in a listed company.

Pooled superannuation trusts and product disclosure

2.19 A pooled superannuation trust is one in which the assets of a number of superannuation funds, approved deposit funds or other pooled superannuation trusts are invested and managed by a professional manager. Pooled superannuation trusts can accept deposits only from complying superannuation funds, complying approved deposit funds, and other pooled superannuation trusts. These are regulated entities typically of significant substance and experience.

2.20 Product disclosure and associated retail client protections in the Corporations Act apply to all investors in pooled superannuation trusts regardless of their nature and scale. In practice, this means that investors in pooled superannuation trusts must be given a PDS, have the benefit of a cooling off period and receive periodic statements even if the investor is itself a large superannuation fund. Other financial services provided by trustees of pooled superannuation trusts are treated differently.

2.21 The bill provides for trustees of superannuation funds, approved deposit funds, pooled superannuation trusts or public sector superannuation schemes with net assets of at least $10 million to be no longer treated as retail clients for the purpose of the product disclosure and related provisions when acquiring an interest in a pooled superannuation trust.

Registered managed investment schemes investing in unregistered managed investment schemes

2.22 Currently, the responsible entity of a registered managed investment scheme may only invest scheme property or keep scheme property invested in another managed investment scheme if that other scheme is registered.[5]

2.23 This restriction is intended to prevent a responsible entity from establishing or investing in an unregistered managed investment scheme to avoid the scheme property protections that apply to registered managed investment schemes.

2.24 A managed investment scheme which operates predominantly outside Australia, such as real estate investment trusts in the United States, will generally not be a registered managed investment scheme. Increasingly registered managed investment schemes seek to diversify their investments among a range of foreign collective investment structures or focus on overseas investments. Generally such investment is not for the purpose of avoiding regulation and is directed to the best interests of members. No such restriction applies to trustees of superannuation funds.

5 Chapter 5C of the Corporations Act (subsection 601FC(4))

2.25 The amendments omit the prohibition on registered managed investment schemes investing in unregistered managed investment schemes.

Company reporting obligations

2.26 The bill will simplify company reporting obligations for companies, helping to reduce compliance costs. The changes include:

- amendments to incorporate in the Corporations Act the accounting standards requirements for executive and director remuneration disclosure;
- increases to the thresholds used to define a large proprietary company and allowance for future changes to the thresholds to be prescribed by regulations;
- changes to notification requirements, payment of annual fees and the company deregistration procedure; and
- allowing companies to make annual reports available on the internet and only require hard copies to be sent to members who request them.

2.27 The bill also introduces a new disclosure requirement in relation to executives and directors hedging their incentive remuneration and several other minor and technical amendments to further refine the framework. The most notable of these are:

- In relation to executive remuneration, the replication of existing regulations into the Corporations Act. This will result in listed companies being required to disclose their policy in relation to directors and key management personnel hedging their incentive remuneration and any relates enforcement mechanisms. One of the important consequences of this change in policy is that all information relating to executive remuneration will be contained within the director's report. Since the accounting standard that deals with executive remuneration will be repealed, the financial statements will not need to include information relating to executive remuneration.
- increasing the thresholds used to define a large proprietary company. A proprietary company will be defined as being large if it satisfies two of the following tests: revenue of $25 million; assets of $12.5 million; and 50 employees. The amendments also allow for future changes to the thresholds to be prescribed by regulations; and
- enabling companies, registered schemes and disclosing entities to make annual reports available on a web site and provide hard copies only to those members who elect to receive them in that form.

Auditor independence

2.28 The bill makes changes to the auditor independence provisions of the Corporations Act. The changes rectify a number of anomalies and unintended consequences that have been identified during the implementation of the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (the CLERP 9 Act). They also respond to lessons learned from public consultation

undertaken during a review of auditor independence, and make a number of amendments designed to improve the effectiveness of the auditor independence requirements.

2.29 The CLERP 9 Act introduced a new requirement that an auditor provide a declaration as to whether the auditor is aware of any contraventions of the auditor independence requirements of the act or of any applicable codes of professional conduct. However, this bill provides that the declaration must either be given when the audit report is given to the directors of the company, registered scheme or disclosing entity or must satisfy the following conditions which provide that:

- the auditor's independence declaration be given to the directors and the directors sign the report within 7 days after the declaration is given to the directors;
- the auditor's report on the financial report be made within 7 days after the directors' report is signed; and
- the auditor's report include a statement to the effect that either the declaration would be in the same terms if it had been given to the directors at the time the auditor's report was made, or circumstances have changed since the declaration was given to the directors, and setting out how the declaration would differ if it had been given to the directors at the time the auditor's report was made.[6]

2.30 These amendments are required to address a timing inconsistency in existing legislation.

Reporting of inadvertent breaches

2.31 Current reporting requires the auditors' declaration to include inadvertent breaches of the auditor independence requirements.[7] In the course of day-to-day audit practice, there would be many examples of inadvertent breaches of the auditor independence requirements which would be quickly addressed once the auditor became aware of the breach.

2.32 The policy intention is that only contraventions which relate to an intentional breach, including both knowledge and a failure to take reasonable steps to rectify the breach, should be included in the statement. The measures in the bill will ensure that an auditor will not be required to report inadvertent breaches of the auditor independence requirements in the declaration. This applies where the auditor had reasonable grounds to believe that, at the time of the contravention, a quality control system was in place that would provide reasonable assurance that the auditor would comply with auditor independence requirements.

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6 subsection 307C(5A)

7 subsections 307C(1) and 307C(3)

Money owed prohibition

2.33 The Corporations Act prohibits an individual auditor, an audit firm or an audit company from owing an amount of more than $5000 to the audited body, a related body corporate or an entity that the audited body controls.[8]

2.34 Even though this restriction had been included in the corporations legislation for over thirty years, during the implementation of the CLERP 9 auditor independence requirements, concerns were raised by the accounting profession that this restriction was catching 'ordinary course of business' transactions between an auditor and an audit client.

2.35 The bill accepts that as a general rule, debts incurred in the ordinary course of business and on normal terms and conditions would not constitute a threat to auditor independence. It provides that a debt owed by the person or firm to a body corporate or entity should be disregarded if the debt:

- is on normal terms and conditions, and arises from the acquisition of goods or services on normal trading terms from the audited body, an entity that the audited body controls, or a related body corporate, and the goods or services will be used by the person or firm:
- is for the personal use of the person or firm; or
- is in the ordinary course of business of the person or firm.[9]

Notification procedures

2.36 The bill provides ASIC with the power to extend beyond the current 28 day period the time within which an auditor is required to resolve a conflict of interest situation. When the CLERP 9 Act was drafted, the maximum period of 28 days was considered to give an auditor sufficient time to rectify a conflict of interest situation. However, concerns have been raised that complex circumstances do arise that would not be able to be resolved with 28 days. ASIC was not given the power to extend this period.

Multiple former audit firm partner restriction

2.37 The report of the HIH Royal Commission recommended that in implementing the proposed CLERP 9 Act, the proposals for restrictions on employment relationships between an auditor and the audit client should include ‘a prohibition on any more than one former partner of an audit firm, at any time, being a director of or taking a senior management position with the client’.

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8 Item 15, subsection 324CH(1)

9 Paragraph 324CH(5)(b)

2.38 This bill recognises that the former partner restriction serves a useful purpose, but that some changes should be made to address the perceived over reach of the existing requirement. The bill proposes that former partners of an audit firm and former directors of an authorised audit firm who had departed from the firm or audit company for five or more years should be excluded from the restriction.

2.39 A minimum five year separation period was considered appropriate because the longer former partners have been out of the firm, the less likely they will be in a position to influence the current professional members of the audit team or be so familiar with the audit approach and testing strategy that they are able to circumvent them. A time limit is also easy to apply and enforce.

Cooling-off period for former audit team partners

2.40 The Corporations Act imposes a mandatory period of two years from the date of departure from the firm before a former partner of an audit firm, or a former director of an audit company, who was on the audit team can become an officer of the audit client. In line with international practice and maximise both flexibility and maintain auditor independence, the bill amends this requirement to start the two year period from the time the person ceased membership of the team auditing the client, as opposed to when they resigned from the audit firm.

Introduction of a 'covered person' approach to existing financial relationship restrictions

2.41 The auditor independence regimes in Australia, Canada, the European Commission, the UK and the US have all adopted specific employment and financial relationship restrictions between an audit firm and an audit client. However, only Australia and the UK apply these restrictions on an 'all partner' basis rather than focusing on those people in the audit firm with a close connection with a particular audit. In the US, a person who has a close connection with an audit is referred to as a 'covered person'.

2.42 The bill redefines the application of the restrictions to people in the firm who are involved in, or in a position to influence the audit.

Miscellaneous amendments

2.43 Miscellaneous other amendments include provision for:

- The extension of ASIC relief powers to exempt members of audit firms, former members, professional employees or directors of an audit firm who are registered company auditors from the auditor independence requirements of Division 3 of Part 2M.4 of the Corporations Act.
- Clarification of the need for auditors of registered managed investment schemes' compliance plans to be suitably qualified.
- The provision of assistance and access to records to the auditor from the licensee or their body corporate.

Corporate governance

2.44 The bill will amend the Corporations Act to remove member approval requirements in relation to small transactions between public companies and related parties. It will also allow delegation to ASIC of certain administrative functions regarding identical or unacceptable company names, and approval of changes to certain corporate constitutions. This will streamline administrative processes for corporations.

2.45 The related party transactions provisions in the Corporations Act[10] require that public companies obtain member approval before they can give any financial benefit to a related party (such as a director, a director's spouse, a controlling entity, or entities controlled by mutual entities), unless the benefit fits within certain exceptions. The current provision allows payments at or below $2000 to related parties who are directors or directors' spouses to be made without member approval. Under the new provision, member approval will not be required for giving a financial benefit to these related parties (ie directors or directors' spouses), which is at or below the prescribed level aggregated over a financial year. It is expected that the amount initially prescribed will be $5000.

2.46 The policy rationale for the related party transactions provisions is to protect shareholders' investments from being eroded by the board approving transactions with related parties that are non-commercial or non-arms'-length in nature. However, the cost for business of obtaining member approval for related party transactions not otherwise allowed by the law can be substantial. If the related party benefit is small, then the compliance cost may well outweigh any governance benefits from requiring member approval.

Approval of identical and otherwise unacceptable company names

2.47 The bill allows for the Minister, by signed instrument, to delegate the function of determining whether a particular company name should be granted, notwithstanding the name is identical or otherwise unacceptable, to a member of ASIC (ie a commissioner) or a staff member of ASIC. At present, a prescribed Minister makes the determination. Conveying to ASIC the ability to determine name applications is in keeping with its role as corporate regulator.

Pre-existing licences allowing companies to omit the word 'limited' from their names

2.48 A number of Australian companies hold a licence to omit the word 'limited' from their names. Such licences were generally issued by State and Territory Attorneys-General during the period when corporate law was a responsibility of the State and Territory Governments.

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10 Part 2E.1

2.49 These licences generally require approval of the Minister responsible for corporate law, or another Minister of the Commonwealth, a State or a Territory, or an officer, instrumentality or agency of the Commonwealth, a State or a Territory for any changes to the constitutions of these companies.

2.50 The bill provides for companies to notify ASIC of changes to their constitutions, replacing the requirement to seek approval for any changes to the constitutions of companies. ASIC will have the power to revoke a company's licence if the company fails to notify ASIC of a change to its constitution, in addition to its current powers to revoke such a licence.

Fundraising

2.51 This bill amends the Corporations Act in relation to fundraising by corporate entities. The amendments are generally intended to streamline fundraising through, for example, removal of unnecessary disclosure requirements, inconsistencies between different parts of the Corporations Act; and amendment of the time periods and amounts that can be raised under particular provisions.

Rights issue disclosure for quoted securities and other financial products

2.52 The first measure amends the disclosure requirements relating to rights issues by listed entities. It provides that such rights issues may be conducted without the provision of a prospectus or PDS. The provision relates only to rights issues of securities and interests in managed investment schemes, and ASIC is given the power to require disclosure if certain requirements are not met by the offeror.

Small scale offerings

The second measure raises the threshold at which an offeror of securities may use an 'offer information statement' rather than a (more complex) prospectus, from $5 million to $10 million.

Secondary sale issues

2.53 This measure seeks to simplify disclosure requirements for controllers of shares in an existing, listed security who wish to sell some or all of the shares on the market. The bill reduces the requirement for the security to have been listed on the market, before reduced disclosure requirement apply, from 12 months to 3 months.

Employee unlisted share schemes

2.54 The bill provides relief from certain restrictions contained in the Corporations Act for employee share schemes for unlisted companies. This will be subject to the condition that such schemes must be accompanied by a disclosure document such as an Offer Information Statement (OIS) or a prospectus. Listed entities may also take advantage of this relief if they wish, subject to the same condition.

2.55 At this stage only employee share schemes involving the issue of securities may use an Offer Information Statement as their disclosure document. Employee share schemes involving a sale of securities (for example through a wholly-owned trustee) will still have to provide a prospectus.

2.56 The following relief from the licensing requirements for eligible offers is provided:

- Relief for an issuer from the requirement to hold an Australian Financial Services Licence for the provision of general advice in connection with the offers.
- Relief for an issuer and its controlled entities from the requirement to hold an Australian Financial Services Licence for dealing in a financial product where the operation of an employee share scheme requires the purchase or disposal of shares which occurs:
  - through a person who holds an Australian Financial Services Licence authorising the holder to deal in financial products; or
  - in an overseas jurisdiction through a person who is licensed or otherwise authorised to deal in financial products in that jurisdiction.
- Relief for an issuer and its controlled entities from the licensing requirement for the provision of a custodial and depository service, including licensing relief for dealing in a financial product in the course of providing such a custodial and depository service.
- Amendments providing relief from the hawking provisions in the Corporations Act for eligible employee share schemes, to allow companies to contact their employees and make participation offers to them.

2.57 Contribution plans are exempted from the managed investment and licensing provisions in the Corporations Act. A contribution plan is an arrangement under which funds are deducted from employees' salaries, including through salary sacrifice arrangements, and used to pay for shares under an employee share scheme.

Advertising rules for offers of securities requiring a disclosure document and for offers of other financial products

2.58 This measure aligns the advertising requirements for offers of quoted securities with the advertising requirements that apply to other financial products. Amendments are also made aligning the advertising provisions applying to offers of unquoted securities after the lodgement of a disclosure document with those applying to other financial products. The provisions regarding advertising of unquoted securities prior to the lodgement of a disclosure document remain unchanged. ASIC's powers are extended to allow it to intervene in case of misleading and deceptive advertising of securities, as it is currently able to do in the case of other financial products.

Takeovers

2.59 Currently, a bidder and a target in a takeover situation must record all telephone calls they make to security holders (other than wholesale holders) to discuss a takeover bid during the bid period. The bill removes this requirement.

2.60 Those who hold 85 per cent or more of a class of securities in a company are also required to notify the company in writing of that fact within 14 days of becoming aware that they possess an 85 per cent holding and then remind the company on an annual basis. The bill also removes the requirement to provide these notices. The repeal of these requirements will remove onerous compliance burdens for bidders and targets involved in company takeovers which are not justified by increased levels of shareholder protection.

Compliance

2.61 The bill will amend the Corporations Act to streamline compliance procedures and ensure companies can access newer technologies. The measures include simplifying returns of company particulars and permitting electronic registration of charges.

Simplifying returns of company particulars

2.62 The bill will allow ASIC to give a company or responsible entity of a registered scheme a request for return of particulars if ASIC suspects or believes that particulars recorded in a registered document are not correct. Currently, such a request may be made where the review fee had not been paid or where documents have not been lodged with ASIC for 12 months or more. The bill also increases the time in which a return of particulars must be lodged with ASIC from 28 days to two months.

Electronic registration of company charges

2.63 The bill provides that, from 1 July 2007, ASIC will offer a facility that allows for the electronic registration of charges. Currently, charges can only be lodged with, and certified by, ASIC on paper.