7 June 2007

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Sir/Madam

Inquiry into the CLA (Simpler Regulatory System) Bill 2007

1. Opening Comments

The Australian Financial Markets Association (AFMA) represents the interests of participants in Australia's wholesale banking and financial markets in respect of regulation and other matters that impact their business. Our members are industry leaders and comprise both Australian and foreign owned institutions, including banks and securities companies; traders in specialised markets; and leading companies.

AFMA supports the introduction of the 'Corporations Legislation Amendment (Simpler Regulatory System) Bill 2007', as it contains a number of measures that will improve the regulatory system for financial services. We expect these initiatives will improve the efficiency of the capital markets to the benefit of business and investors more generally.

AFMA has made submissions to the Corporate and Financial Services Review in support of several recommendations that are taken up in the Bill and we comment briefly on of these specific measures below.

2. Fundraising Amendments

2.1 Rights Issue Disclosure

AFMA supports the proposal to streamline the process for rights issues of quoted securities and other financial products by relying on continuous disclosure and a cleansing notice, instead of requiring the issuance of a prospectus or Product Disclosure Statement. This would reduce costs and improve the efficiency of transactions.

Member firms have a commercial interest in maintaining investor confidence in the integrity and fairness of the capital market. In this context, we are satisfied that the proposed conditions are necessary and sufficient to ensure that the market operates in an informed and efficient manner, such that it will both protect investors thoroughly and more effectively meet the needs of securities issuers.

2.2 Small Scale Offerings [item 76, section 708(9A)]

AFMA supports the proposal to align the definition of wholesale/sophisticated investors in Chapters 6D and 7 of the Act. A consequence of the current inconsistency is that a client may require a separate accountant's certificate for transactions covered by each Chapter, which greatly diminishes the benefit of the changes made in the regulations for some member firms and reduces market access for clients that are affected. [1]

However, there is concern in industry about the reference in the notes to sections 708(9B) and 9(C) to section 50AA, which gives meaning to the term 'control' in this context. The effect is to impose a narrow view on the meaning of 'control', which in practical terms would defeat the purpose of the relief in some situations. Many investors choose to access investment opportunities using trust structures to make the investment. However, ASIC has advised that where a person controls a company that is trustee of a trust, you cannot include the income or the assets of the trust for the purpose of the test.[2]

We believe the general definition of control adopted in subsection 708(11)(b) and Regulation 7.602AE is more appropriate in this instance and would give a more consistent outcome across the law. In this regard, we note that the Explanatory Statement to the Corporations Amendment Regulations 2005 (No. 5) which introduced Regulation 7.6.02AE states that control is to be given its ordinary meaning which, according to the 2003 edition of the Macquarie Dictionary is "to exercise restraint or direction over …".

To achieve this outcome, we recommend that the note to sections 708(9B) and 9(C) should be deleted and reliance be placed on the ordinary meaning of control, as in subsection 708(11)(b).

2.3 Secondary Sales

AFMA supports the proposed amendment in relation to secondary sales. These embody a number of technical changes that will improve the operation of the law.

The Bill proposes to amend section 708A(5)(a) and section 1012DA(5)(a) so that the reference to 12 months is replaced with 3 months. The existing requirement is unnecessarily stringent given the underlying regulatory objectives. ASX is highly regarded as a supervisor of its continuous disclosure rules and the market price discovery process experience is efficient.

We support the technical changes to the timing provisions relating to the release of the cleansing notice, as our members have sought this to improve the practical working of this part of the Act.

AFMA supports the proposal to specify that s.708A apply to secondary sales of securities transferred by controllers without disclosure, subject to the requirements outlined in the Act. This will reduce regulatory compliance cost for controllers by removing the need for ASIC relief on a case by base basis.

3. Sophisticated Investors [item 100, section 761GA]

Item 100 of the Bill inserts a mechanism whereby a financial services licensee can certify that a client has sufficient experience to be treated as a wholesale client. This is subject to conditions; the licensee must be satisfied on reasonable grounds that the client is well placed to assess the attributes (including risk) of the product

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[1] The *Corporations Amendment Regulations 2005 (No. 5)* expanded the scope of wholesale clients in Chapter 7 of the Act but the regulations do not apply to the sophisticated investor and professional investor exemptions in Chapter 6D.
[2] Certificates issued by a qualified accountant; 28 March 2006.

or services and provide the client with a written statement of the reasons for being satisfied about these matters. In addition, the client must sign an acknowledgement of the consequences of being treated as wholesale.

AFMA believes that it is necessary to have in place such stringent controls in order for the measure to operate effectively for both financial services licensees and their clients. Indeed, member firms who have experience in applying section 708(10) of the Act (which broadly corresponds to this) advise that it places significant responsibility and risk on licensees, so it is used infrequently and prudently. We expect that the application of this concept in the context of Chapter 7 would be similarly applied with a high degree of caution.

However, there are a couple of design features in the measure in the Bill that would substantially undermine its value from a practical perspective.

3.1 Exclusion of Small Business

The most serious problem in this regard relates to the requirement in section 761GA(c) that "the financial product or service is not provided for use in connection with a business". In practice, we envisage the proposed mechanism to have been of most benefit in the context of servicing small business.

For example, a small company that sells its goods overseas may frequently conduct foreign currency transactions with a licensee and, thus, is experienced in this area and should be recognised as such for regulatory purposes.

There is no obvious policy rationale for preventing business entities from availing themselves of the mechanism, since if an entity is considered to be sophisticated based on its experience and it wishes to be treated in this manner, then the fact that it is a business would not in any way diminish the integrity, rigor or value of the assessment process. In other words, the fact that they are a business does not in any way diminish their sophistication – indeed, businesses would generally have accounting and compliance support, so the opposite might be expected.

We note that the nature of the 'assets and income' wholesale client test in section 761G(7)(c), which also does not apply to supplies in connection with a business is very different to that contemplated here. A small business might easily meet the assets and income test intended for application to individuals by virtue of its property, equipment and turnover, however, a test of sophistication is not subject to this scalability issue.

We note that the corresponding section dealing with securities in Chapter 6D, section 708(10), applies irrespective of the status of the person as a business.

3.2 Other Issues

Subsection 761GA(f) provides:

> "The client signs a written acknowledgment before, or at the time when, the product or service is provided that:
> (i) the licensee has not given the client a Product Disclosure Statement; and
> (ii) the licensee has not given the client any other document that would be required to be given to the client under this Chapter if the product or service were provided to the client as a retail client; and
> (iii) the licensee does not have any other obligation to the client under this Chapter that the licensee would have if the product or service were provided to the client as a retail client."

As presently drafted, this subsection may introduce unnecessary complications.

In particular, members have advised the wholesale client may have been given a copy of a Product Disclosure Statement (PDS) for a variety of reasons; for example, because they were previously a retail client or because the PDS contains a helpful description of the product. Moreover, in some instances a client may be assessed as a wholesale client under section 761GA for some products or services, but not for others. Thus, the licensee would have to provide a Financial Services Guide (FSG) to the client, where the FSG covers the full range of its services.

In addition, the reference to "the product or service" in this subsection could be read to suggest that an assessment must be made in relation to each product and service provided. To be of any real value, the test would have to be readily applicable to the ongoing provision of financial services, as well as one-off sales situations (especially as the experience assessment would be based in part on the frequency with which a person deals in a product). It should also cover a class of financial products.

If ASIC is unable to provide policy guidance that offers comfort on these points, then the technical drafting of the law may need to be revisited.

4. Telephone Monitoring During Takeover Bids

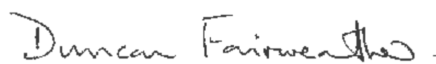
AFMA supports the proposal to repeal the provisions in the Act which relate to telephone monitoring during takeover bids. These provisions contain detailed requirements on the identification, indexing, storing, destruction, accessing and copying of recordings of telephone conversations with retail shareholders during takeover bids.

The requirement for a bidder or target to record telephone calls made to retail securities holders during the period of a takeover bid imposes a cost on industry but does not appear to deliver a compensating public benefit. Accordingly, it would be in the interest of market efficiency to remove this requirement, which would be consistent with the recommendation of the Parliamentary Joint Committee on Corporations and Securities in 2001.[3]

Concluding Comments

Implementation of the measures in the Bill would fit well within the framework of the Government's broader and welcome initiative to reduce the regulatory burden on business. Therefore, we support the Bill and would encourage the Committee to recommend its acceptance by Parliament, taking account of the points we have raised here.

Yours sincerely



Duncan Fairweather
Executive Director

[3] Report on the Financial Services Reform Bill 2001, issued in August 2001.