Corporations Amendment Regulations 2004 (No. 2) 2004 No. 25

EXPLANATORY STATEMENT

Statutory Rules 2004 No. 25

Issued by the Parliamentary Secretary to the Treasurer

Corporations Act 2001

Corporations Amendment Regulations 2004 (No. 2)

Subection 1364(1) of the *Corporations Act 2001* (the Act) provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed by regulations or necessary or convenient to be prescribed by such regulations for carrying out or giving effect to the Act.

The *Financial Services Reform Act* 2001 (FSRA) commenced on 11 March 2002. It amended the Act to introduce a uniform licensing, conduct and disclosure regime for financial service providers. Under the FSRA, a two-year transition period was established to allow time for existing industry participants to enter the new regime.

The purpose of the Regulations is to support the reforms to the regulation of the financial services industry which were implemented in the FSRA and associated legislation. The Regulations facilitate transition to the new licensing, conduct and disclosure arrangements and promote certainty, clarifying, where necessary, various provisions under the FSRA.

The Regulations include amendments that:

- improve the operation of the disclosure regime;
- specify a number of things that are not financial products; and
- provide conditional exemptions from the FSRA licensing regime. Details of the Regulations are set out in the Attachment.

Regulations 1 to 3 and Schedule 1 commence on gazettal.

ATTACHMENT

DETAILS OF THE *CORPORATIONS AMENDMENT REGULATIONS 2004 (NO. 2)*

Regulation 1 provides that the name of the Regulations is the *Corporations Amendment Regulations 2004 (No. 2).*

Regulation 2 provides that regulations 1 to 3 and Schedule 1 commence on gazettal.

Regulation 3 provides that Schedule 1 of the Regulations amend the *Corporations Regulations 2001* (the Principal Regulations).

Schedule 1 - amendments commencing on gazettal

Item 1 Meaning of class of financial services - regulation 7.1.04E.

Division 6 of Part 7.6 of the *Corporations Act 2001* (the Act) deals with the liability of licensees for the conduct of their representatives. A key aspect of whether a licensee is responsible for the conduct of a representative turns on the meaning of the expression "class of financial service".

The meaning of "class of financial service" is not certain, particularly where a representative may act on behalf of more than one licensee. In relation to insurance, for example, a representative might represent one licensee (licensee A) in respect of life insurance products, and another licensee (licensee B) in respect of general insurance products.

The term "class of financial service" could be given a broad interpretation - for example, providing advice on, or dealing in, a financial product. Using the above example, if such an interpretation is adopted, both licensee A and licensee B may be potentially liable for all of the conduct of the representative, even though the representative is only authorised to act on their behalf in relation to life and general insurance products respectively.

This wide interpretation may be leading to a reluctance on the part of licensees to 'cross-endorse' representatives (a representative that wishes to represent more than one licensee must obtain the consent of all of the licensees - section 916C).

Regulation 7.1.04E identifies, for the purposes of subsections 917A(3), 917C(2) and 917C(3), each of the following as a class of financial service:

- the provision of financial product advice relating to a general insurance product;
- the provision of financial product advice relating to an investment life insurance product;
- the provision of financial product advice relating to a life risk insurance product;
- dealing in a financial product that is a general insurance product;
- dealing in a financial product that is an investment life insurance product; and
- dealing in a financial product that is a life risk insurance product.

General insurance product, investment life insurance product, and *life risk insurance product* are all defined in section 761A of the Act. The regulation would not diminish the consumer protection provided by the liability provisions. The list is not intended to be exhaustive, but would assist in identifying the activities of representatives for which licensees are responsible and consequently make cross-endorsement more attractive.

Item 2 Specific things that are not financial products: Australian Capital Territory Insurance - regulation 7.1.07H.

The regulation results in insurance provided by the Australian Capital Territory being treated in the same manner as that of other States and Territories.

Paragraph 765A(1)(e) of the Act provides that State insurance and Northern Territory insurance are not financial products for the purposes of the FSR Act. However, there is no

reference to Australian Capital Territory insurance as paragraph 765A(1)(e) reflects subsection 9(2) of the *Insurance Contracts Act 1984* (ICA) and the Australian Capital Territory was not self-governing at the time the ICA was enacted.

Paragraph 765A(1)(y) of the Act provides that a facility, interest or other thing declared by regulations made for the purpose of subsection 765A(1) is not a financial product. The regulation excludes Australian Capital Territory insurance from the definition of a financial product along similar lines to other States and Territories as provided for in paragraph 765A(1)(e).

Item 3 Risk advice - amendment to regulation 7.1.29.

Regulation 7.1.29 of the Principal Regulations sets out circumstances in which a person is taken not to provide a financial service, in effect, conduct which is exempt from the new regime.

The amendments to the regulation would extend the scope of the relief it provides to allow generic risk management advice that is not restricted merely to business clients. This allows other clients, such as private individuals, to receive basic advice that they should make risk mitigation arrangements, such as to take out insurance. The relief would be restricted to the presence of a risk that a person may face and does not allow the recommendation of specific advice about financial products, for example, those provided by a particular issuer.

Item 4 Accountants and self-managed superannuation funds - new regulation 7.1.29A

Paragraph 7.1.29(5)(c)(ii) of the Principal Regulations indicates that a person provides an exempt service if advice is given in relation to a superannuation product and that advice does not include a recommendation to acquire or dispose of that product.

The purpose of the amendment is to provide an exemption from the FSRA for recognised accountants making a recommendation that a person acquire or dispose of a self-managed superannuation product.

The amendment only applies in relation to self-managed superannuation as opposed to other superannuation products. Self-managed superannuation funds are often used as a tool to implement FSRA-exempted advice given by accountants, such as business structuring advice and taxation advice. The exemption for self-managed superannuation would therefore be in keeping with the policy of exempting such advice from the FSRA. Further, the exemption would be limited to the following members of professional bodies, which are subject to continuing educational and ethical requirements:

- members of CPA Australia who are entitled to use the post-nominals "CPA" or "FCPA", and are subject to and comply with CPA Australia's continuing professional education requirements;
- members of the Institute of Chartered Accountants in Australia (ICAA) who are entitled to use the post-nominals "CA", "ACA" or "FCA", and are subject to and comply with ICAA's continuing professional education requirements; and

- members of the National Institute of Accountants (NIA) who are entitled to use the post-nominals "PNA", "FPNA", "MNIA" or "FNIA", and are subject to and comply with the NIA's continuing professional education requirements.

Item 5 Licensing of overseas derivative counterparties - regulation 7.6.01(1)(ma).

An International Swaps and Derivatives Association (ISDA) master agreement can be used to establish a framework for future derivative trading between two parties, by setting out the terms and conditions for those future transactions.

Due to the combined application of subsection 911D(1), subsection 761E(5), and section 766C, an overseas entity that is a party to an ISDA derivative contract may be required to hold an Australian Financial Services Licence.

Subsection 761E(5) deems each person who is a party to a derivative, which is not entered into or acquired on a financial market, to be an issuer of the product. Section 766C states that issuing a financial product constitutes 'dealing' for the purposes of the FSRA licensing regime.

If the overseas entity deals in derivatives (due to subsection 761E(5) and section 766C) to an Australian client under an ISDA agreement, subsection 911D(1) works to ensure that the overseas entity is considered to be conducting a business 'in this jurisdiction' and hence requires a license to enter that trade.

The regulation exempts an overseas entity from the requirement to hold a licence, where the following conditions were met:

- derivatives are traded under a contract which sets out the terms and conditions for future derivative trading between two parties (the agreement);
- the first party is not in this jurisdiction (overseas counterparty);
- the second party to the contract is an Australian wholesale client (Australian counterparty);
- the agreement was initiated/established by the Australian counterparty;
- the Australian counterparty holds an Australian Financial Services Licence which permits it to make a market or deal in the financial product to which the agreement relates; and
- both the overseas counterparty and the Australian counterparty are dealing on their own behalf, in the financial product that is the subject of the agreement.

This regulation only exempts dealings occurring through a formal arrangement. The exemption is not intended to extend to ad hoc transactions, which could be seen as creating a greater risk to market integrity.

Item 6 Notification of authorised representatives: basic deposit products - regulation 7.6.04B.

Part 7.6 of the Act deals with licensing of providers of financial services. Paragraph 926B(1)(c), in Part 7.6, provides that the regulations may provide that this Part applies as if specified provisions were omitted, modified or varied as specified in the regulations.

This item would insert regulation 7.6.04B, which is made under paragraph 926B(1)(c) of the Act. The effect of the regulation is to modify paragraph 916F(1AA)(d), which relates to the notification to the Australian Securities and Investments Commission (ASIC) of the appointment of certain authorised representatives. Paragraph 916F(1AA)(d) currently provides that notification to ASIC of the appointment of representatives is not required where those representatives only provide general advice on, or deal in, financial products specified in the regulations.

Regulation 7.6.04B modifies paragraph 916F(1AA)(d) to add a subparagraph (iii), the effect of which is that the appointment of an authorised representative who gives personal advice about a basic deposit product or a facility for making non-cash payments that relate to a basic deposit product, would not have to be notified to ASIC (provided that the requirements of paragraphs 916F(1 AA)(a) to (c) are also met).

Items 7, 11 to 15 Meaning of *able to be traded* - amended regulations 7.7.02, 7.8.17, 7.8.20, 7.8.21 & 7.9.63B.

The expression "able to be traded", in relation to products on a financial market, is used in a number of provisions in Chapter 7 of the Act. The expression is defined in section 761A, and may include all types of financial products that a licensed market is authorised to trade. The definition is necessarily quite broad. However, in some cases the breadth of that expression may impose significant regulatory obligations that will be difficult to comply with, particularly where an Australian Financial Services Licence holder is not in a position to participate in the licensed market on which the relevant financial product is able to be traded.

Australian market licences are issued in broad terms, so that a licensed market is authorised to trade a wide range of financial products, such as derivatives or securities. This means that all types of derivatives or securities may be "able to be traded" on a financial market that is licensed.

The regulations in these items limit the expression "able to be traded" in various provisions -- namely, subsection 941 C(8) (item 7), subsection 991 B(2) (items 11 and 12), paragraphs 991 E(1)(c) and (d) (item 13), subsection 991F(3) (item 14) and paragraphs 7.9.63B(6)(a) and (b) of the Corporations Regulations (item 16).

The breadth of the expression "able to be traded" means that a licensee may not know whether a particular financial product is able to be traded on a financial market on which the licensee is not a participant or does not have access through a third party. The regulations are aimed at limiting the application of the obligation to trading on licensed markets where a licensee may trade either directly or indirectly. This would overcome the difficulties associated with the breadth of the definition of "able to be traded" in relation to licensees that are not participants on the relevant licensed market referred in these specific provisions, but would not affect the definition in other, contexts.

For example, amended regulation 7.7.02(5B) clarifies that for subsection 941C(8), a Financial Services Guide does not have to be given in certain circumstances where it may not be possible for a person to ascertain if a financial product is able to be traded on a financial

market in which the person is not a participant. The Product Disclosure Statement (PDS) obligation would continue to apply (as applicable).

Item 8 Identity of authorised representatives in a Financial Services Guide - amended regulation 7.7.05B.

This regulation removes the need to disclose the identity of an individual or corporate authorised representative in a Financial Services Guide (FSG) where their identity or remuneration is not material in the decision to acquire a financial service.

The amendments extend the relief from FSG content requirements provided only to individuals by the existing regulation 7.7.05B. The amendments allow generic references (as opposed to each by name) in the FSG to both individual and corporate authorised representatives. This will facilitate more streamlined FSGs for licensees. The relief recognises that when the identity or remuneration of the authorised representative is not useful in making a decision about acquiring a financial service, its provision is unnecessary and will not be required. An example is a salaried worker in a call centre whose salary is not sales-linked and their identity is not useful information for the customer. In contrast, the identity of an authorised representative who receives a sales based commission should be disclosed in the FSG as this information could be relevant to the client's decision to acquire a financial product.

The exclusion from the content of a FSG would only apply to the identity of the authorised representative. Other content requirements would still have to be met, such as remuneration. It is not expected that the remuneration of an individual or corporate authorised representative where the identity or remuneration is immaterial would have to be disclosed beyond general terms. This is consistent with the disclosure required for an employee of a licensee.

The regulation is also limited to the financial services of dealing and general advice. This is because in these instances, the identity of the authorised representative is not likely to have a material impact on the decision to acquire the financial service. In contrast, for other financial services, such as the provision of personal advice, it is more likely that the identity of the authorised representative will be a material consideration for a retail client.

The amendments to subregulation 7.7.05B(1) ensure access to this relief can be used by corporate licensees and authorised representatives who authorise a person to deliver a service on behalf of a licensee.

Exemption from providing certain information in a Financial Services Guide - regulation 7.7.05C.

This amendment ensures that an FSG is not required to disclose information about a basic deposit product or non-cash payment facility, given these financial products do not require a FSG to be provided in the first place.

Under subsection 941C(6), a FSG is not required for a financial service provided in relation to a basic deposit product or non-cash payment facility. However, where the providing entity

conducts a financial service in relation to another financial product that does require a FSG, it must contain information about all 'authorised services', which would mean that details about the financial products under subsection 941C(6) would have to be given, even though there is a general FSG exemption for these products.

The amendment allows a providing entity to exclude certain information from its FSG. The relief is limited to information about authorised services and remuneration that applies to a financial service covered by subsection 941 C(6). This ensures that the relief is limited to the financial services directly and exclusively reflected in subsection 941C(6).

Items 9 and 10 Australian Financial Services Licence (AFSL) number and authorised representative numbers - regulations 7.7.06A and 7.7.11A.

The FSG and Statement of Advice (SoA) given by an authorised representative must identify the authorising licensee. These regulations make it clear that an authorised representative's FSG and SoA must include the authorising licensee's AFSL number.