

EXPLANATORY MEMORANDUM

Minute No. _____ of 2010 - Minister for Financial Services, Superannuation and
Corporate Law

Subject - *Corporations Act 2001*
Corporations Amendment Regulations 2010 (No. _____)

Section 1364 of the *Corporations Act 2001* (the Principal 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 regulations, for the carrying out or giving effect to the Principal Act.

The purpose of these proposed Regulations is to bring the acquisition of limited recourse borrowing arrangements (including instalment warrants) by superannuation funds into the Government's consumer protection framework.

Generally, superannuation funds are not permitted to borrow funds except in limited circumstances. Superannuation funds are regulated under the *Superannuation Industry (Supervision) Act 1993* (SIS Act). Limited recourse borrowing arrangements, such as instalment warrants, are one of the exceptions permitted under the SIS Act, under subsection 67(4A).

Limited recourse borrowing arrangements, usually a form of an instalment warrant, are a sophisticated financial derivative product, involving an investment in an underlying asset. These assets include shares, securities and real property. These borrowing arrangements involve an up front payment to the issuer with the balance being paid-up in periodic instalments. Borrowing arrangements carry a degree of market risk. It is to mitigate these risks that the Act's consumer protections for superannuation funds are considered necessary.

The Government is concerned that superannuation funds may be investing in assets through borrowing arrangements without fully understanding the risks involved. Superannuation funds may be receiving inappropriate advice when purchasing instalment warrants from unlicensed and unqualified dealers. When purchasing from unqualified sources, superannuation funds are without access to consumer protections, such as product disclosure, indemnity insurance or dispute resolution mechanisms.

These proposed Regulations would make limited recourse borrowing arrangements financial products under the Principal Act when entered into by regulated superannuation funds.

The proposed Regulation would extend the Principal Act's consumer protections to superannuation funds when purchasing instalment warrants. Under the Principal Act, those dealing in (providing advice and issuing) financial products must have an Australian Financial Services Licence (AFSL). AFSL holders are legally required to provide consumer protections to their clients.

To avoid overlap or unintended avoidance the proposed Regulations will make it clear that borrowing arrangements are not credit facilities under the Principal Act when entered into by superannuation funds.

Accordingly, the proposed Regulations amend the *Corporations Regulations 2001* (the Principal Regulations) to provide that:

- limited recourse borrowing arrangements are financial products under the Principal Act when acquired by superannuation funds;
- limited recourse borrowing arrangements are not a credit facility under the Principal Act when acquired by superannuation funds; and
- an AFSL covering derivatives is taken to also cover limited recourse borrowing arrangements.

To this end, paragraph 764(1)(m) of the Principal Act provides that the regulations can declare a product to be a ‘financial product’ for the purposes of that section. In addition, paragraph 765A(h)(i) provides that a ‘credit facility’ is defined under the regulations. Regulation 7.6.01AA(1) of the Principal Regulations modifies section 911A of the Principal Act to give the power to deem that coverage of a financial product by an existing Australian Financial Service Licence (AFSL) may extend to covering another financial product.

The proposed Regulations would deem that an AFSL covering derivatives also applies to limited recourse borrowing arrangements. This will reduce the burden on AFSL holders without reducing consumer protection. AFSL holders covering derivatives will not need to re-apply for a separate AFSL to issue or provide advice about instalment warrants.

Details on these proposed Regulations are set out in the Attachment.

The Principal Act specifies no conditions that need to be satisfied before the power to make the proposed Regulations may be exercised.

The proposed Regulations would be a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

The Regulations would commence three months after they are made

This Minute recommends that the regulations be made in the form proposed.

Authority: Sections 764, 765 and 1364 of the
Corporations Act 2001

ATTACHMENT TO EXPLANATORY MEMORANDUM

Details of the Corporations Amendment Regulations 2010 (No.)

Regulation 1 — Name of Regulations

This regulation would provide that the name of the Regulations is the *Corporations Amendment Regulations 2010 (No.)*.

Regulation 2 — Commencement

This regulation would provide for the Regulations to commence on 29 September 2010.

Regulation 3 — Amendment of *Corporations Regulations 2001*

This regulation would provide that Schedule 1 of the Regulations amends the *Corporations Regulations 2001* (the Principal Regulations).

Schedule 1

Item [1] – After regulation 7.1.04G

Item [1] would insert a new regulation 7.1.04H in the Principal Regulations.

Regulation 7.1.04H would provide that a limited recourse borrowing under subsection 67(4A) of the *Superannuation Industry Supervision Act 1993* (SIS Act) is declared to be a financial product under the Principal Act.

Item [2] – After sub-regulation 7.1.06(2)

Item [2] would insert a new sub-regulation 7.1.06(2A) in the Principal Regulations.

Sub-regulation 7.1.06(2A) would provide that a limited recourse borrowing under subsection 67(4A) of the SIS Act is not a credit facility under the Principal Act.

Item [3] – Regulation 7.1.06B

Item [3] would omit regulation 7.1.06B in the Principal Regulations.

Regulation 7.1.06B has been redundant for some time and this opportunity will be used to remove it. Other than that, it has no relation to the proposed amendments.

Item [4] – After regulation 7.6.01AA

Item [4] would insert a new regulation 7.6.01AB in the Principal Regulations.

Regulation 7.6.01AB would provide that an AFSL which covers the provision of a financial service in relation to a derivative is taken to cover limited recourse borrowings under subsection 67(4A) of the SIS Act.