

**EXPLANATORY INFORMATION FOR THE PROPOSED GOVERNMENT
AMENDMENTS TO THE FINANCIAL SERVICES REFORM AMENDMENT BILL 2003**

TOPIC 1

Items 1 to 24 (T1A) - proposed replacement of Schedule 1 – unsolicited offers to purchase financial products off-market

It is proposed that Schedule 1 of the FSR Amendment Bill 2003 be replaced with an amended Schedule 1. The updated Schedule differs from the original, due to the following amendments:

Inviting a person to make an off-market offer

Due to the current wording of Schedule 1 to the Bill, the potential buyer of a financial product could structure a document to invite someone to make them an offer, at a price set by the invitee, and thereby avoid the off-market dealing provisions.

An amendment is proposed to ensure that inviting someone to sell his or her financial product off-market would be an offence. Instead, if a person desires to deal in financial products off-market, they would have to make an offer in the form required by Schedule 1. This proposed prohibition would only apply to invitations that, if structured as an offer, would be caught by the new provisions of Schedule 1.

People who received an unlawful invitation would be allowed certain rights of remedy (existing section 1019H) and the access to the civil liability provisions. That is, the offeree would have the right to terminate the contract and as such, refuse to transfer the financial product to the offeror, or if that transfer has already taken place, the right to have the financial product returned. Such a right would be available for up to 30 days after the contract was entered into.

Civil recourse would also be available to the offeree (through an amendment to Division 7, Subdivision B of Part 7.9). That is, a person that received an unlawful invitation would be able to seek compensation for losses arising from an acceptance of that invitation.

It is proposed that non-compliance with the new provisions would constitute an offence and result in appropriate penalties.

Variation of the offer document

It is proposed that the terms of an offer (as set out in the offer document), to which Schedule 1 applies, should not be able to be varied by either party.

This restriction would not affect the ability of an offeror to make a lawful withdrawal of the offer and make a new offer, nor would it stop an offeree making a separate counter offer.

Supplementary disclosure

It is proposed that additional disclosure be required from off-market dealers, where the actual market value of the product under offer varies from the disclosed market value, by a percentage greater than that specified in the regulations. Pursuant to such a variation, off-market dealers would have to withdraw their offer (and subsequently make another offer) or send the offeree a supplementary offer document. The purpose of the supplementary offer document would be to disclose the market value variance only. That is, the terms of the original offer could not be varied

through the issue of the supplementary offer document, and the document is to include a statement to this effect.

In that regard, if an offeror wished to amend the terms of the original offer document, the offer must be withdrawn and a new offer made.

It is proposed that non-compliance with the new provisions would constitute an offence and result in appropriate penalties.

Where the offeror is required to provide a supplementary offer document, but a sale takes place without such disclosure (or the disclosure is provided after the completion of the sale), the offeree would have the right to terminate the contract (as per existing section 1019H).

Such rights would also be available to the offeree where the supplementary offer document is defective, or contains a misleading or deceptive statement.

In the above instances, offerees would also have access to the civil liability provisions.

TOPIC 2

Items 1A, 4A, 4B & 7A (T2A-T2C) - definition of professional investor

These items amend the definition of *professional investor* in section 9 to make clear that it excludes trustees of superannuation funds with assets of less than \$10 million. It is arguable that the definition as currently drafted includes such trustees, which is not intended.

Amendments are also made to move the definition of *body regulated by APRA* from the definition section (section 761A) in Chapter 7 of the Act to the general definition section (section 9) at the beginning of the Act. The definition itself will not change.

TOPIC 3

Item (T3A) – omission of items 19 to 24 of Schedule 2

It is proposed that items 19 to 24 of Schedule 2 be omitted. These items would have amended sections 889J and 889K which provide for levies to support the National Guarantee Fund. They were drafted in the light of the first stage of the ASX's restructuring of its market and clearing and settlement arrangements. However, they do not fit the details of the later stages which have now been developed. For this reason, it is proposed that they be omitted from the Bill.

TOPIC 4

Items 12A & 12B (T4A) - bundled insurance products

The proposed amendments to section 764A of the Act provide a consistent basis for determining when general insurance products are provided to retail clients, irrespective of whether the products are provided individually in separate contracts of insurance or provided in a 'bundled' contract of insurance. A bundled contract of insurance is a single contract that includes a range of insurance covers, from which consumers are able to choose which of those various insurance covers they wish to acquire.

- A general insurance product is currently defined in paragraph 764A(1)(d) by reference to a ‘contract of insurance’.
- Subsection 761G(5) provides that certain types of general insurance (eg. home contents, consumer credit, sickness and accident) are taken to be provided to a retail client, where the client is an individual or the insurance product is or would be used in connection with a small business. Those types of general insurance are classified under the operation of subsection 761G(5) and associated Corporations Regulations 7.1.11 to 7.1.17.

The proposed amendments maintain the principle of providing protection through disclosure for retail clients, whereas wholesale clients do not require the same level of protection. The amendments remove an unintended distinction made between wholesale and retail clients for general insurance products based on whether or not the products are provided within a bundled contract.

The proposed amendments utilise the kinds of insurance covers and underlying assets to distinguish between classes of general insurance products contained within a bundled contract. For example, insurance cover in respect of the destruction or damage to a home building can be distinguished from insurance cover in respect of the destruction or damage to commercial premises. This basis is consistent with that already used in Corporations Regulation 10.2.74.

By making these amendments, disclosure and other obligations under Part 7.9 of the Act will not apply to the extent provisions of a bundled contract of insurance relate to general insurance products considered to be provided to wholesale clients. This outcome is consistent with that of similar general insurance products provided in separate contracts of insurance.

The proposed amendments only apply for the purposes of determining what constitutes a general insurance product (and therein a financial product) and do not have a general effect on the meaning of ‘contract of insurance’ when used elsewhere in Chapter 7 of the Act.

TOPIC 5

Items 13, 13A & 13B (T5A) - expert statements

Under section 766B, giving an ‘exempt document or statement’ is not considered to be the provision of financial product advice. An ‘exempt document’ is defined under subsection 766B(9). The nature of an exempt document means that a report by an expert (such as a valuation provided by a merchant bank), even if normally considered to be financial product advice, will not be classified as financial product advice if it is included in an exempt document.

The proposed amendment to subsection 766B(1) is designed to achieve the same outcome as the original amendments to subsection 766B(1) introduced in the FSR Amendment Bill. The intention is to ensure that experts who give reports about financial products do not automatically receive the benefit of the exempt document status in which their reports appear. It was considered the original amendment did not achieve this result. This change will not detract from the intent behind exempt documents but will ensure that the provision of financial product advice does not escape licensing merely by appearing in an exempt document.

TOPIC 6

Items 91A, 91C & 91D (T6A & T6B) - Stop orders by ASIC

Amendments are proposed to the ASIC stop order provisions (section 1020E) to ensure that they are consistent with the operation of similar provisions within Chapter 6D of the Act (sections 728 and 739). That is, the ASIC stop order provisions will be permitted to operate in relation to non-materially adverse circumstances subject to existing due process requirements.

- Currently section 1020E gives ASIC the power to prohibit sales or issues of products based on ‘defective’ disclosure documents. The definition of defective used in this context is that under the offence provisions of Part 7.9 and is subject to a materiality constraint.

The proposed new subparagraph 1020E(1)(a)(ia) relating to stop orders is being amended to also accommodate other changes to the Act that relate to a verbal PDS under paragraph 1012G(3)(a) and an offer document as specified in Division 5A.

TOPIC 7

Items 77A-B, 78A-T, 95A-C & 96A (T7A to T7D) - Interaction between provisions of Part 7.9 (sections 1012J, 1016A to 1016E and Division 7)

Clarifying ‘up to date’ and ‘defective’ concepts

Amendments are proposed to provide greater certainty for the operation of the concept of ‘up to date’ contained within section 1012J. In particular, its interaction with the meaning of ‘defective’ under the criminal and civil liability provisions of Part 7.9 provisions is to be clarified.

The proposed amendments to subsections 1021B(1) and 1022A(1) provide that inclusion of information that is not up to date in a PDS is considered a misleading or deceptive statement for the purposes of determining when a disclosure document or statement is defective.

Further, the omission of information relating to occurrence of new circumstances that may influence a retail client’s investment decision from a disclosure document or statement may constitute an omission for the purposes of determining when a disclosure document or statement is defective.

Consistent terminology will be applied across other provisions within section 1016E (ie, those relating to ‘new circumstances’ arguably already incorporate the up to date requirements but do not use a consistent terminology). In this regard, as paragraphs 1016E(1)(c) & (d) will be substituted and proposed subsection 1016E(5) inserted, direct reference will be made to the term defective, as opposed to outlining the respective sub-components.

Eligible applications & non-defective PDS

Section 1016A of the Act currently requires an eligible application to be one that is taken from a PDS that contains ‘all’ of the required information as at the time of the application.

It is proposed to amend the definition of ‘eligible application’ under section 1016A so that restricted issues or sales of financial products may occur or that a person may become a ‘standard employer-sponsor’ in relation to a superannuation entity, provided that the application received is derived from a PDS that is not defective at the time of the application.

- Restricted issues or sales are defined in section 1016A with reference to the requirement for a responsible person to provide a PDS prior to the acquisition of a financial product.
- Defective (and therein ‘not defective’) for these purposes is defined with reference to the criminal liability provisions of Part 7.9 and is therefore subject to consideration of whether the consumer would be subject to materially adverse effects as a result of misstatements or omissions.

Section 1016E currently prescribes those circumstances in which issues or sales and employer-sponsor arrangements may occur where an application has been received based on a defective PDS (subject to materially adverse effects). Neither of the current sections 1016A or 1016E provide an avenue through which persons can proceed with an issue or sale where an application is derived from a PDS that is subject to non-materially adverse defects – that is, issues or sales in those instances are effectively prohibited in such circumstances.

Given the non-material nature of the subject defects to the relevant investment decision, it is considered that allowing for issues or sales of financial products would not diminish the ability of the client to make an informed investment decision. To require specific rectification of each and every minor defect through additional disclosure might result in undue disclosure obligations being imposed on the product issuer.

Under the proposed amendments persons supplying supplementary disclosure documentation that contains non-materially adverse misstatements or omissions would be open to the operation of the civil liability provisions. Accordingly, if a person suffers a loss through these ‘non-material’ deficiencies it would be open to them to seek restitution through the existing civil liability provisions under Subdivision B, Division 7 of Part 7.9.

Action maybe available to ASIC through the stop order provision in relation to PDS, which will not be limited to a PDS which contained materiality adverse misstatements or omissions under other proposed amendments (see Topic 6).

When considered in conjunction with proposed clarification of the relationship between defective and up to date concepts, the proposed amendment also caters for circumstances involving a superseded PDS. The issue or sale of a financial product may be able to occur based on such an outdated PDS provided that there was nothing materially adverse to the client’s decision that was not disclosed.

Choices related to applications received based on defective PDS & revised PDS

The insertion of proposed paragraphs 1016E(2)(aa) and 1016E(2)(ba) allows for the provision of a revised PDS (instead of a supplementary PDS – section 1014A) in circumstances related to the issue of products where an application is based on a defective PDS. This will provide an alternate practical means of addressing deficient PDSs.

Corporations Regulation 7.9.13A currently provides for the ability to provide a revised PDS, however it is considered preferable for these provisions to be included within the Act.

Choices related to applications received based on defective PDS & pre-requisites for issues or sales of financial products under sections 1016A to D

It is proposed that the interaction of section 1016E (relating to applications based on a defective PDS) and section 1016A (relating to eligible applications) be clarified. There is currently no clear linkage between the operation of sections 1016A and 1016E.

These proposed amendments permit the original application to constitute an eligible application for the purposes of section 1016A. Proposed subsections 1016E(2A) and (2B) deem that an original application received by the responsible person (ie. an application derived from a defective PDS) is taken to have come from a revised PDS or supplementary PDS issued for the purposes of satisfying paragraph 1016E(2)(b). Further, amendments to section 1016E are required to align the provision of a replacement PDS or a supplementary PDS with the eligible application provisions.

Consequential amendments have also been necessary to clarify the interaction of sections 1016B to D, which relate to pre-acquisition conditions for the issue or sale of a financial product, with the operation of section 1016E.

- Where a PDS is lodged with ASIC, section 1016B prohibits the issue or sale of the specified financial product for a specified period - note this requirement does not apply to a supplementary PDS.
- Section 1016C restricts a responsible person's ability to issue or sell a financial product where minimum subscription conditions apply.
- Section 1016D restricts a responsible person's ability to issue or sell a financial product where conditions apply in relation to the trading of the subject product on a financial market.

It is proposed that section 1016B will not apply to a revised PDS provided in circumstances specified by section 1016E. This is consistent with the treatment of supplementary PDS in the same circumstances.

Sections 1016C and 1016D will not have effect where the responsible person opts to proceed with an issue or sale under the circumstances outlined in paragraphs 1016E(2)(ba) and 1016E(2)(c). This outcome is consistent with the current intent of section 1016E, which permits an issue or sale to proceed subject to the provision of a supplementary PDS that 'changes the statement' related to the pre-requisite conditions described in sections 1016C and 1016D.

Where the responsible person decides to retain the application but not proceed with the issue or sale at that time, sections 1016B to D requirements will remain in effect for any subsequent issue or sale.

Technical amendment

For consistency, it is proposed under Item 78A that paragraph 1016A(2)(f) be amended to permit making of regulations in relation to both restricted issues or restricted sales, rather than just restricted issues as it is currently drafted.

TOPIC 8

Item 47A (T8A) - exemptions from the section 949A obligation to warn the client

General advice must be accompanied by the general advice warning found in section 949A (such as this advice has not taken personal circumstances into account). However, it may not be practical to give this warning every time general advice is provided. For example, if the general advice is provided in a radio advertisement, it may not be practical to provide a detailed warning.

It is proposed to include a regulation-making power in subsection 949A to specify limited situations when, even though general advice has been provided, the general advice warning will not have to be given. It is envisaged this will only be in situations where consumer protection will not be reduced through not being provided with the warning. An example could be when a person advertises in the media to the world at large. However, it is not envisaged the warning would be excluded where there is potential for an investor to be significantly influenced, for example, when they attend seminars run by financial advisers.

TOPIC 9

Items 71A-B, 95AA-AR, 96AA-AS & 114 (T9A-T9D) - Section 1012G oral statement requirements

Paragraph 1012G(3)(a) currently allows a product provider, in time critical issue or sale situations, to read a statement prepared by the issuer of a financial product rather than satisfy the general requirement to provide a PDS prior to the issue. However, that person must also provide a PDS as soon as practicable after that time (in any event by the time of any confirmation or not later than 5 days after issue).

- The time critical component is determined through whether it is reasonably practical to provide a PDS subject to meeting express instructions from a client.

Industry have argued that as currently drafted these ‘verbal PDS’ provisions may pose practical difficulties and impose undue costs because they are interpreted as requiring the reading of a ‘block’ statement (which might, for example, take some minutes to deliver over the phone).

The proposed amendments to paragraph 1012G(3)(a) will, rather than impose a requirement to read a prepared statement, permit a regulated person to provide the same information in an unscripted form. In doing so, the proposed amendments would remove practical difficulties associated with the reading of a block statement by permitting information to be provided in more tailored manner without reducing the disclosure obligations. For example, during a telephone call a regulated person would still be obliged to provide all the information during the course of the conversation currently required under paragraph 1012G(3)(a) but may be able to respond to any queries a client may have as they give the information.

The proposed amendments also remove the requirement for the information to be given based on material prepared by the product issuer. This would remove practical difficulties and potential conflicts for intermediaries who are independent of the product issuer. For example, an independent intermediary might not have immediate access to the statement prepared by the product issuer.

The proposed removal of reliance on an issuer prepared statement affects the criminal and civil liability provisions within Part 7.9. Those provisions currently rely on the issuer prepared statement as a basis for determining what is a defective disclosure document or statement (and hence subject

to criminal or civil liability). Amendments to the definition of ‘disclosure documents or statements’ and various other references within liability provisions are also affected.

Accordingly, it is necessary to adjust the application of liability provisions to reflect the actions of the persons actually giving or preparing the information. Consequently this involves the proposed insertion of new liability provisions and penalties within Part 7.9.

The proposed civil liability provisions distinguish between the product issuer/authorised representatives’ relationship and other financial services providers in determining their application. As such where the person giving the information is an authorised representative of the product issuer, the product issuer is subject to the operation of the civil liability provisions.

The new liability provisions and associated penalties are based on comparable criminal and civil liability provisions that operate for Part 7.7 of the Act, in relation to the oral provision of FSGs and SoAs. For example, proposed section 1021FA is based on existing subsections 952D(1) and 952E(1), (2), (5) and (6), and proposed section 1021FB is derived from sections 952F and 952G.

Further, it should be noted that the proposed amendments would permit the liability provisions to apply to information provided, including information purporting to be that required by paragraph 1012G(3)(a).

The proposed amendments to the Part 7.9 criminal and civil liability provisions are to ensure those disclosure obligations remain effective, enforceable and attach appropriate liabilities for actions.

It should be noted that the current section 1020E stop order provisions provide ASIC with the ability to prevent a person being able to utilise the verbal PDS provisions where they have provided defective information in relation to a financial product.

TOPIC 10

Items 103A, 104A & 104B (T10A-T10B) - Transitional period for sections 1414, 1426 & 1428

These items amend sections 1414, 1426 and 1428 to provide that the transitional period ends when a market or clearing and settlement facility licence is varied. The current provisions (which provide for the end of the transition period upon the licensee lodging an application to vary its licence) do not accord with the desirable and efficient processing of applications to vary the license and approval of compensation arrangements. This consequence was not envisaged when the provisions were originally drafted.

TOPIC 11

Items 1A to 1E (T11A) - ASIC Act amendments

Items 1A and 1B - section 12AE – saving of State and Territory laws

The proposed amendments contained in these items address a potential inconsistency that may exclude or limit the application of the unconscionable conduct provisions of State and Territory fair trading laws.

Items 1C and 1D - subsection 12BAB(10)

These items make amendments to subsection 12BAB(10) that are equivalent to the amendments to subsection 766C(7) of the *Corporations Act 2001* made by items 14 and 15 of Schedule 2 to the FSR Amendment Bill.

Item 1E - paragraph 127(4C)(a) - confidentiality

Section 127 of the ASIC Act imposes confidentiality obligations in relation to information that is given to ASIC in confidence or in connection with the performance of its functions or the exercise of its powers under the corporations legislation. Subsection 127(4B) authorises disclosure of this information under certain circumstances to a body corporate specified in relations under subsection 127(4C). Subsection 127(4C) allows the regulations to specify a body corporate for the purposes of subsection 127(4B) if, and only if, the body corporate conducts a financial market or holds an Australian clearing and settlement facility licence.

The proposed amendment to subsection 127(4C) would expand the range of bodies corporate that can be prescribed under subsection 127(4C) to include bodies corporate that are involved in the supervision of a financial market (but which do not actually conduct a financial market themselves). This amendment is intended to ensure that ASIC is able to disclose information in accordance with subsection 127(4B) to companies that are involved in supervising financial markets (such as Regulation Services Inc, a company established jointly by the Toronto Stock Exchange and the Canadian Securities Dealers Association to regulate broker conduct in relation to Canadian financial markets), not just to market operators.