

EXPLANATORY STATEMENT

Issued by authority of the Minister for Financial Services and Superannuation

Corporations Act 2001

Corporations Amendment (Water Trading Exemptions) Regulation 2013

Section 1364 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, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

Paragraph 761D(3)(d) of the Act provides that the Corporations Regulations 2001 (the Principal Regulations) may declare anything not to be a derivative for the purpose of Chapter 7 of the Act.

The purpose of the *Corporations Amendment (Water Trading Exemptions) Regulation 2013* (the Regulation) is to ensure that tradeable water rights and arrangements in relation to tradeable water rights are treated under Chapter 7 of the Act in a similar manner to tangible property and arrangements in relation to tangible property. It does this through exempting tradeable water rights, and certain arrangements to buy and sell these rights, from the definition of a derivative under the Act.

The Regulation provides clarity for participants in water markets on the extent to which tradeable water rights and arrangements in relation to trade these rights are regulated under Chapter 7 of the Act. It clarifies how tradeable water rights and arrangements in relation to tradeable water rights may be regulated as financial products, how services in relation to them may be regulated as financial services and the extent to which certain facilities in relation to them may be regulated as financial markets or clearing and settlement facilities. The Regulation also ensures appropriate regulation of water market intermediaries required to hold an Australian Financial Services Licence or operators of water markets required to hold an Australian Market Licence.

The Australian water market is composed of several separate water markets, differentiated by administrative or physical water resource boundaries. The water market facilitates trades in tradeable water rights by a wide range of participants, including governments, irrigators and water market intermediaries.

Each State and Territory maintains responsibility for legislative and administrative arrangements for water rights and water trading. The Murray-Darling Basin Plan, made under the *Water Act 2007* (Cth), includes water trading rules which commence on 1 July 2014. These rules deal with trading or transfer of tradeable water rights in relation to the resources of the Murray-Darling Basin. Water market rules and three sets of water charge rules have also been made under the *Water Act 2007*. The water market rules ensure that an irrigation infrastructure operator cannot prevent or unreasonably delay transformation of an irrigator's right to water into a statutory title and trade of that right.

The trading of 'tradeable water rights' involving intermediaries is also regulated under the *Competition and Consumer Act 2010* and state and territory fair trading laws.

The Regulation will apply to all tradeable water rights and derivative contracts whether entered into before or after the commencement date of the regulations. The Regulation reduces the regulatory obligations that water market participants may potentially be required to comply with and do not directly or indirectly impose additional obligations or alter existing property rights or contractual rights.

Details

Details of the Regulation are included in the [Attachment](#).

Conditions

The Act specifies no conditions that need to be met before the power to make the proposed Regulation may be exercised.

The Regulation is a Legislative Instrument for the purposes of the *Legislative Instruments Act 2003*.

Description of Consultation

The Exposure Draft Regulation was released for public consultation on 7 May 2013.

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Corporations Amendment (Water Trading Exemptions) Regulation 2013

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview of the Legislative Instrument

This Legislative Instrument exempts tradeable water rights, and certain arrangements to trade these rights, from the definition of a derivative.

The purpose of the Legislative Instrument is to create certainty for water market participants about whether tradeable water rights and agreements to trade these rights are derivatives (and therefore financial products) under the *Corporations Act 2001*.

Human rights implications

This Legislative Instrument does not engage any of the applicable rights or freedoms.

Conclusion

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.

Details of the Corporations Amendment (Water Trading Exemptions) Regulation 2013

Regulation 1 – Name of regulation

This regulation provides that the name of the Regulation is the *Corporations Amendment (Water Trading Exemptions) Regulation 2013*

Regulation 2 – Commencement

This regulation provides for the Regulation to commence on the day after it is registered.

Regulation 3 – Authority

This regulation provides that the Regulation is made under the *Corporations Act 2001*.

Regulation 4 – Schedule(s)

This regulation provides that Schedule 1 amends the *Corporations Regulations 2001* (the Principal Regulations).

Schedule 1 – Amendment

Item [1]

Item 1 replaces existing subregulation 7.1.04(8) with a new subregulation 7.1.04(8) and inserts new subregulations 7.1.04(9) and 7.1.04(10) into the Principal Regulations.

Paragraph 7.1.04(8)(a) provides that tradeable water rights *per se* will not be considered to be derivatives for the purposes of Chapter 7 of the Act.

Subregulation 7.1.04(10) clarifies that the term ‘tradeable water rights’ has the same meaning as in the *Water Act 2007* (Cth).

The non-singular ‘tradeable water rights’ is used in subregulations 7.1.04(8) and (10) because the plural of the term is used in the definitions in the *Water Act 2007*. The singular can be taken as a reference to the plural, and vice versa by virtue of the operation of section 23 of the *Acts Interpretation Act 1901*.

The types of rights that are covered by the term ‘tradeable water rights’ are water access rights, water delivery rights and irrigation rights. Definitions for each of these terms are provided for in the *Water Act 2007*.

Tradeable water rights are not likely to fall within the general definition of a ‘financial product’, as provided for in section 763A of the Act. However, if not excluded from the definition of derivative by this sub-regulation, they may be categorised as a derivative and included within the definition of financial product under paragraph 764A(1)(c).

Subregulation 7.1.04(8)(b) provides for a carve-out from the definition of a derivative for certain arrangements in relation to tradeable water rights. The carve-out mirrors that contained in subsection 761D(3) of the Act in relation to certain arrangements in

relation to tangible property, differing to the extent necessary to reflect the intangible nature of tradeable water rights and the possibility that an arrangement may involve the transformation of an irrigation right into a water access entitlement.

Subsection 761D(3) of the Act does not apply to arrangements in relation to tradeable water rights as it is an element of subparagraph 761D(3)(a)(i) that the arrangement be in relation to tangible property. The primary differences between subsection 761D(3) of the Act and the new subregulation are detailed below.

Subparagraphs 7.1.04(8)(b)(i)-(iv) specify that the carve-out of arrangements in relation to a tradeable water right is limited to arrangements which meet a specified set of criteria.

Subparagraph 7.1.04(8)(b)(i) specifies that the first criterion is where one party has, or may have, an obligation to sell a tradeable water right on a future date.

Subparagraph 7.1.04(8)(b)(ii) specifies the second criterion that another party has, or may have, an obligation to buy the tradeable water right (the same right as referenced in subparagraph 7.1.04(8)(b)(i)), or a water access entitlement that is granted, issued or authorised as a result of transformation arrangements described in subsection 97(1) of the *Water Act 2007*, on a future date.

The reference to ‘a water access entitlement that is granted, issued or authorised as a result of transformation arrangements’ is to ensure that the exception will apply to arrangements where an agreement has been made between a buyer and a seller to trade a right, and that agreement includes the transformation of that right from an irrigation infrastructure operator-issued irrigation right to a government-issued water access entitlement to enable the trade to occur.

Subregulation 7.1.04(10) clarifies that the term ‘water access entitlement’ has the same meaning as in the *Water Act 2007* (Cth). Transformation arrangements, as provided for in the *Water Market Rules 2009*, provide for the transformation of the whole, or part, of an irrigation right into a water access entitlement. Transformation arrangements are defined in paragraph 97(1)(a) of the *Water Act 2007*.

The third criterion required to be met for the exception to apply is specified in subparagraph 7.1.04(8)(b)(iii), and is equivalent to that contained in subparagraph 763D(3)(a)(ii) of the Act. This ensures that, for the exemption to apply, the arrangement cannot provide for the trade to be satisfied other than by the transfer of ownership of the tradeable water right. The provision in the Act makes reference to the delivery of the tangible property subject to the arrangement. As the concept of delivery has a special meaning in the context of water trading and as delivery is a notion associated with tangible property rather than intangible property (such as a tradeable water right), this sub-paragraph instead provides for a requirement of ‘transfer of ownership of the tradeable water right’.

The fourth criterion of the exception is specified in subparagraph 7.1.04(8)(b)(iv). This sub-paragraph is intended to have equivalent application to subparagraph 763D(3)(a)(iii) of the Act in a water trading context. Namely, neither usual market practice nor the rules can allow the seller’s obligation to be closed out by setting off one arrangement with another arrangement of the same kind under which the seller has an offsetting obligation to buy the tradeable water right for the exclusion to apply. The absence of usual market practice or rules implies that ‘setting off’ is not allowed, and therefore the exclusion from the definition of a derivative in subparagraph 7.1.04(8)(b)(iv) will apply.

Item 1 inserts subregulation 7.1.04(9) which provides that the arrangements described in subregulations 7.1.04(4) to (8) are not derivatives, whether or not a matter mentioned in those subregulations is described in subsection 761D(1) of the Act. The new subregulation 7.1.04(9) replicates the former subregulation 7.1.04(8), with an additional reference to the new subregulation 7.1.04(8). Subsection 761D(1) of the Act defines the term 'derivative' for the purposes of Chapter 7 of the Act.

- Subregulation 7.1.04(4) refers to forward contracts for the purchase and sale of tangible property (other than Australian or foreign currency).
- Subregulation 7.1.04(5) refers to arrangements involving the sale of property where consideration may vary with reference to a general inflation index.
- Subregulation 7.1.04(6) relates to contracts for the future provision of services.
- Subregulation 7.1.05(7) states that financial products described in section 764A(1) of the Act, other than paragraph 764A(1)(c) which specifically relates to derivatives, are not arrangements to which subregulation 7.1.04(2) applies. Subregulation 7.1.04(2) describes the circumstances in which an arrangement may be declared to be a derivative under subsection 761D(2) of the Act.

The exclusion of tradeable water rights and certain arrangements in relation to tradeable water rights from being a derivative will result in those rights, and trades in those rights, not falling within the definition of a financial product solely on the basis of being a derivative. Paragraph 764(1)(c) of the Act provides that a derivative is a financial product.

This will have a consequential impact on whether the provisions in Chapter 7 in relation to financial services, financial markets and clearing and settlement facilities will apply in relation to tradeable water rights and certain arrangements in relation to tradeable water rights.

Section 766A of the Act provides that dealings in a financial product, financial product advice and market making in relation to financial products will be a financial service. Chapter 7 regulates the provision of financial services. In particular, Part 7.6 provides for a licencing regime in relation to financial services businesses, under which a person who carries on a financial services business must hold an Australian Financial Services Licence covering the provision of the financial services.

The effect of subregulation 7.1.04(8) is to ensure that dealings in tradeable water rights and certain arrangements in relation to tradeable water rights, financial product advice and market making in relation to such rights and arrangements are not financial services under Chapter 7 of the Act. Consequently, water market intermediaries who would otherwise satisfy section 766A of the Act in relation to tradeable water rights will not be carrying on a financial services business and therefore will not be required to hold an Australian Financial Service Licence.

Chapter 7 also regulates the conduct of both financial markets and clearing and settlement facilities. Section 767A defines a 'financial market' with reference to offers or invitations to acquire or dispose of financial products. Part 7.2 provides for a licensing regime in relation to financial markets. Part 7.2A of the Act provides for the Australian Securities and Investments Commission (ASIC) to supervise financial markets. Section 768A defines a 'clearing and settlement facility' with reference to

transactions relating to financial products. Part 7.3 of the Act provides for the licensing of clearing and settlement facilities.

Operators of markets in tradeable water rights and certain arrangements in relation to tradeable water rights that satisfy subregulation 7.1.04(8) will not be required to hold Australian Market Licences for those markets or be required to apply to be exempt from holding such a licence. They will also not be subject to regulation by ASIC as a financial market.

Similarly, operators of facilities that provide a mechanism for the clearing or settlement of transactions relating to tradeable water rights and certain arrangements in relation to tradeable water rights that satisfy subregulation 7.1.04(8) will not be required to hold an Australian Clearing and Settlement Facility licence or apply to be exempt from holding such a licence. They will also not be subject to regulation by ASIC as a clearing facility or a settlement facility.