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Refinements to Financial Services Regulation

After an extensive consultation process the Corporations Amendment Regulations 2005 No. 5 (the New Regulations) were made on 15 December 2005.

Key message

This edition of the Middletons FS newsletter contains a summary of:

- » refinements made to financial services regulation in response to the Financial Sector Advisory Council's report into the industry's experience following the introduction of the Financial Services Reform Act 2001
- » a new ASIC Class Order which grants responsible entities of managed investment schemes a limited discretion in setting the price for new units and withdrawals.

The New Regulations are intended to:

- » ensure that consumers receive information that is relevant to their needs
- » reduce the compliance burden on industry
- » clarify the intent of the legislation that applies to the financial services industry.

In addition, the jurisdictional reach of the financial services regime is clarified to ensure that foreign financial service providers do not require an Australian financial services licence in specified circumstances and Australian licensees are exempt from disclosure requirements when dealing with overseas clients.

Whether these changes are adequate has been questioned by industry stakeholders. Whilst it is generally agreed that the New Regulations are a step in the right direction, further refinements need to be made to achieve Treasury's aims.

In broad terms the New Regulations impact three categories of financial service providers:

- » financial product advisers
- » product issuers
- » general insurers.

1. Providers of Financial Product Advice

1.1 Tailored FSGs

The New Regulations modify a number of the requirements for Financial Services Guides (FSGs) to promote shorter FSGs that are more relevant to the client's needs, such as:

- » FSGs may be tailored to only contain information about services or products that the client is likely to receive
- » where the FSG duplicates information in a

PDS given to the client, the licensee may not need to provide the client with an FSG

- » where the remuneration or other benefits the licensee will receive cannot be ascertained when the FSG is given, general information about the remuneration or other benefits and the manner in which they will be calculated may be given, if certain disclosures are made.

1.2 Further advice

The existing Further Market-Related Advice exemption is effectively extended to all further advice given by a financial services provider, subject to certain conditions being met and additional disclosure being given in the FSG of the service provider.

Where a service provider has an ongoing relationship with a retail client and there has been no material change in the client's personal circumstances or the basis of the advice since the client received the first Statement of Advice (SOA), the service provider is not required to provide a subsequent SOA but can instead keep a record of the subsequent advice for 7 years and provide it to the client upon request.

1.3 Wholesale client definition

The definitions of 'retail client' and 'wholesale client' have been modified by:

- » allowing the assets or income of a trust or company controlled by the investor to be aggregated with the assets or income owned or received by the investor directly, for the purposes of determining whether an investor is a 'wholesale client'

- » extending the definition of ‘professional investor’ to include a person controlling or having \$10 million in gross assets
- » extending the period for renewal of accountants’ certificates to 24 months.

1.4 Secondary service providers (SSPs)

Following a long period of consultation with industry, the New Regulations modify FSG requirements for SSPs who have no direct relationship with the client.

Where an SSP provides a service to a client via an unrelated intermediary who is either a licensee or an authorised representative, the SSP will not be responsible for giving the client an FSG. The SSP and the intermediary will, however, need to have a written agreement that either the intermediary will give the SSP’s FSG to the client or will inform the client how to obtain the SSP’s FSG.

1.5 Certain advice not a financial service

The New Regulations provide for two circumstances in which the provision of general advice will not be regarded as a ‘financial service’.

First, where a person provides advice which is neither personal advice nor advice about a particular financial product, this will not be regarded as a financial service if:

- » the advice is not intended or could not reasonably be regarded as being intended to influence a person in making a decision about a particular financial product
- » as a result of giving the advice neither the adviser nor their associate receives any remuneration or other benefit.

Secondly, product issuers without an advice authorisation may provide advice in relation to any financial products they issue where:

- » the advice is not personal advice
- » at the time the advice is given, the issuer:

- tells the person they are not licensed to give financial advice about the product
- recommends that the person obtain and read the PDS before making a decision to acquire the product
- notifies the person of any cooling off period.

Product issuers who are authorised to provide financial product advice do not qualify for this relief and will remain subject to disclosure requirements, including the provision of FSGs. Submissions to Treasury suggested this was inappropriate and, potentially, unfair, but the relief was not extended.

1.6 Authorised Representatives

The New Regulations allow all forms of business structure to ‘sub-authorise’ individuals to act on behalf of a licensee. Previously, only corporate authorised representatives were granted this power.

Further, where an authorised representative sub-authorises its employees and the sub-authorisation is limited to providing financial services, ASIC notification is not required.

It was proposed that the authorised representative be required to maintain a register of sub authorisations, but criticism of the costs and complexity involved persuaded Treasury to remove this requirement. The authorised representative will, however, be required to answer reasonable inquiries about any individuals they sub authorise.

2. Product issuers

2.1 Short-form PDSs

In an attempt to provide consumers with more effective disclosure, the New Regulations allow product issuers (other than general insurers) to provide retail clients with a short-form PDS that summarises specified information from the PDS and notifies clients that a full PDS is available on request. Full fee disclosure must

be included, but other information may be incorporated by reference provided that certain requirements are met.

Submissions to Treasury raised concerns that short-form PDSs may not be significantly shorter or less complex than full PDSs, particularly as fee information cannot be summarised. Further, substantial implementation and compliance costs will be incurred in producing two disclosure documents for a single product.

A short-form PDS that is designed as a 'consumer guide' that explains product features to ordinary consumers may be useful if the full PDS becomes a document intended to meet legislative requirements, without any marketing statements or appearance. Whether the industry embraces the short-form PDS remains to be seen.

2.2 Basic Deposit Products and CMTs

Basic Deposit Products (BDP), including related non-cash payment facilities and travellers' cheques, are now excluded from disclosure requirements. Product issuers must simply inform the client about the costs of the product and any amounts that may or will become payable and ask the client if they would like further information on such costs.

The disclosure requirements for CMTs have also been relaxed so that neither an FSG nor an SOA is required. A PDS is, however, still required to allow customers to understand the different nature of a CMT. A number of industry groups, including IFSA, sought to have CMTs excluded from the PDS requirements on the basis that CMTs are operationally similar to BDPs and, as Treasury has stated, 'relatively more straightforward than other financial products'. Although this proposal was rejected, IFSA has vowed to pursue further relief.

Product issuers may also be affected by the New Regulations relating to the wholesale

client definition (section 1.3) and the limited circumstances where the provision of general advice will not be deemed a financial service (section 1.5). In certain time critical cases, they may also be able to provide the simplified oral disclosure set out in section 3.1.

3. General insurers

3.1 Simplified oral disclosure

In time critical situations, a PDS for certain financial products with a cooling off period can be given to a client later than would otherwise be required, provided certain oral disclosures are made.

The New Regulations reduce the oral disclosure required to:

- » the name and contact details of the issuer
- » information about the applicable cooling off regime
- » a recommendation that the client consider the information in the PDS that will be subsequently provided
- » asking the client whether they would like further information about the product and providing such further information.

Because a cooling off period applies, consumers will be able to read in the PDS and return the product if they choose. Accordingly, the PDS must be provided to the client as soon as practicable but within five business days of the issue of the product or the time when confirmation is required.

IFSA sought this relief to be extended to the anti-hawking provisions relating to unsolicited phone calls. This was rejected and the lengthy oral disclosure requirements continue to apply to unsolicited phone calls.

3.2 PDS content requirements

On the basis that general insurance products are subject to both the *Insurance Contracts Act* 1984 (ICA) and the Corporations Act, the PDS

content requirements have been modified for general insurance products. The New Regulations clarify that information about significant risks, tax implications and other information relevant only to investment products is not required.

The New Regulations require, in effect, that the entire insurance policy document be included. As a result, the content of the policy wording is exposed to all Corporations Act requirements, including the requirement to be 'clear, concise and effective'. This has raised concern for many general insurers.

Comments were also received that general insurance products and life insurance products should be treated consistently this was not accepted.

3.3 Supplementary PDSs

The New Regulations also permit a general insurer to give an insured a supplementary PDS (SPDS) on renewal of their insurance policy

provided that a full PDS was given when they first acquired the policy. The SPDS would only contain changes to the policy that had occurred subsequent to the original PDS.

The general insurance industry submitted that this was unnecessary as an insurer could already be entitled to issue an SPDS to update a PDS.

3.4 SOAs no longer required for certain insurance products

The New Regulations also exempt advisers who provide personal advice to retail clients about most general insurance products from giving the client an SOA, on the basis that such products are generally well understood by consumers. SOAs will need to be provided for consumer credit insurance and accident and sickness insurance products, which are considered more complex.

Pricing discretion in MIS Constitutions

At the end of the hectic pre-Christmas period, ASIC released Class Order 05/1236 which in effect reverses ASIC's previous interpretation of section 601GA of the Corporations Act in relation to the requirement for registered managed investment scheme's (MIS) constitution to make adequate provision for the consideration paid to acquire an interest in the scheme.

Previously, ASIC had interpreted section 601GA to mean that an MIS constitution must contain a mechanism that was 'certain, complete and independently verifiable for calculating the transaction costs component of the price of an interest in the scheme' and

that if the responsible entity (RE) was allowed a discretion to determine any part of the issue or withdrawal price, then the constitution did not comply with section 601GA.

Following industry submissions arguing for greater commercial flexibility and further investigation of widespread practice in the funds management industry, CO 15/1236 now permits REs to exercise limited discretion when making pricing decisions provided this discretion is transparent and adequate safeguards are put in place to ensure the RE acts reasonably in the exercise of its discretion.

Further information

Melbourne

Jim Bulling

Partner

T: +61 3 9640 4338

F: +61 3 9205 2055

E: jim.bulling@middletons.com.au

Sydney

Rowan McDonald

Partner

T: +61 2 9513 2525

F: +61 2 9513 2399

E: rowan.mcdonald@middletons.com.au