



## Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009

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Law and Bills Digest Section

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## Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009

**Date introduced:** 25 June 2009

**House:** House of Representatives

**Portfolio:** Treasury

**Commencement:** The formal provisions, Schedule 3 (item 1) and Schedules 4 and 5 commence on Royal Assent; Schedules 1, 2 and Schedule 3 (items 2 and 3) commence on a single day to be fixed by Proclamation, or six months after Royal Assent, whichever occurs first.<sup>1</sup>

**Links:** The [relevant links](#) to the Bill, Explanatory Memorandum and second reading speech can be accessed via BillsNet, which is at <http://www.aph.gov.au/bills/>. When Bills have been passed they can be found at ComLaw, which is at <http://www.comlaw.gov.au/>.

### Purpose

The Bill amends the *Corporations Act 2001* (the Corporations Act) and the *Australian Securities and Investments Commission Act 2001* (the ASIC Act) to regulate margin lending and trustee corporations on a national basis. Particularly, any person providing and advising about margin loans will need to hold an Australian financial services licence (sometimes known as an ‘AFSL’) and be subject to the licensing, conduct and disclosure requirements contained in the Corporations Act and administered by ASIC. The Bill also aims to improve the regulatory framework that applies to the issuing of promissory notes and debentures.

### Background

What is a ‘margin loan’?

In short, ‘margin lending’ is the borrowing of money to invest in the stock market. According to ‘FIDO’, the consumer website of the Australian Securities and Investments Commission (ASIC), a margin loan:

... lets you borrow money to invest in shares and other financial products, using existing investments as security. Borrowing money to invest in this way, also known as ‘gearing’,

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1. **Schedules 1, 2 and Schedule 3 (items 2 and 3)** may in fact commence on three separate days.

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can increase the gains from an investment, but also multiply the losses. Margin loans are offered by a wide range of financial institutions and are often available online.<sup>2</sup>

FIDO goes on to explain the risk of borrowing money to invest in shares. For example, when an investor takes out a loan to invest in shares, a margin lender usually takes a mortgage over the shares, so that if the value of the shares falls below the value of the loan, the lender can sell the shares to realise the value of the loan. To protect himself or herself against any possible shortfall between the amount owing on the loan and the value of the shares, a margin lender will usually limit the amount of gearing (or borrowing) to a set percentage of the shares. The percentage is known as the ‘Loan-to-Value Ratio’ (or LVR) and is usually set at a maximum of 70 per cent. A borrower must usually fund the remaining 30 per cent of the purchase price of the shares from other sources. This 30 per cent shortfall is known as the ‘margin’. If the value of the shares falls below the LVR level that applies to those shares, then the lender may make a ‘margin call’, meaning that the borrower has to top up the loan to the LVR in order to keep the loan viable.<sup>3</sup>

Margin lending grew from less than \$5 billion in 1999 to \$32.6 billion in March 2008.<sup>4</sup>

### How is margin lending currently regulated in Australia?

At present, margin lending is largely unregulated in Australia—both at Commonwealth and State level.

#### Commonwealth

The Uniform Consumer Credit Code (the UCCC or the Code)—which currently forms the basis of a scheme of state-based consumer credit legislation—does not apply to credit provided for investment purposes. **Paragraph 6(1)(b)** of the UCCC states that the Code applies where ‘the credit is provided or intended to be provided wholly or predominantly for personal, domestic or household purposes’. It therefore does not apply to margin loans, which are by their nature used to finance investment.

Chapter 7 of the Corporations Act, which deals with financial services and markets, does not cover credit. Further, regulation 7.1.06 of the Corporations Regulations 2001 makes it clear that **credit facilities** are not financial products for the purposes of

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2. FIDO, *About financial products: Margin Loans*, <http://www.fido.asic.gov.au/fido/fido.nsf/byheadline/borrowing+money+to+invest+margin+lending?openDocument#>, viewed 17 August 2009.
  3. FIDO, *About financial products: Margin Loans*, op. cit.
  4. The Treasury, *Green Paper on Financial Services and Credit Reform*, 3 June 2008, viewed 30 July 2009, <http://www.treasury.gov.au/contentitem.asp?NavId=002&ContentID=1381> and D Crowe, ‘Crackdown on margin lending’, *Australian Financial Review*, 4 June 2008, pp. 1 and 8.

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subparagraph 765A(1)(h)(i) of the Corporations Act.<sup>5</sup> Although they are not mentioned by name, margin loans would meet the definition of ‘credit facility’ in regulation 7.1.06—and thus are not covered by Chapter 7 of the Corporations Act.

Also, Part 5 of the *Trade Practices Act 1974* (the TPA), which deals with consumer protection, does not apply to ‘the supply, or possible supply, of services that are financial services’: section 51AF of the TPA. The term ‘*financial services*’ is defined in section 4 of the TPA as having the same meaning as in Division 2 of Part 2 of the *Australian Securities and Investments Commission Act 2001* (the ASIC Act). Division 2 of Part 2 of the ASIC Act deals with ASIC and consumer protections in relation to financial services. The term ‘*financial service*’ is defined in subsection 12BAB(1) of the ASIC Act as follows:

- (1) For the purposes of this Division, subject to paragraph (2)(b), a person provides a *financial service* if they:
  - (a) provide financial product advice (see subsection (5)); or
  - (b) deal in a financial product (see subsection (7)); or
  - (c) make a market for a financial product (see subsection (11)); or
  - (d) operate a registered scheme; or
  - (e) provide a custodial or depository service (see subsection (12)); or
  - (f) operate a financial market (see subsection (15)) or clearing and settlement facility (see subsection (17)); or
  - (g) provide a service that is otherwise supplied in relation to a financial product; or
  - (h) engage in conduct of a kind prescribed in regulations made for the purposes of this paragraph.

Generally, the term ‘*financial product*’ is defined in subsection 12BAA(1) of the ASIC Act as ‘a facility through which, or through the acquisition of which’, a person makes a financial investment, manages financial risk, and/or makes non-cash payments. Further, paragraph 12BAA(7)(k) provides that a ‘*credit facility*’, as defined in the Australian Securities and Investment Commission Regulations 2001 (ASIC Regulations), is a ‘financial product’. Regulation 2B defines ‘*credit facility*’ for the purposes of

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5. Section 765A of the Corporations Act sets out the specific things that are not financial products. For the full text of regulation 7.1.06 of the Corporations Regulations 2001, see [http://www.austlii.edu.au/au/legis/cth/consol\\_reg/cr2001281/s7.1.06.html](http://www.austlii.edu.au/au/legis/cth/consol_reg/cr2001281/s7.1.06.html), viewed 17 August 2009. Note, however, that under the ASIC Act (and the ASIC Regulations), a credit facility is a financial product.

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12BAA(7)(k).<sup>6</sup> While neither the ASIC Act nor the ASIC Regulations refers specifically to margin lending, it does seem to be a ‘*financial product*’ for the purposes of the ASIC Act, which means that the offences contained in that Act would apply to a person who provides a ‘financial service’ in relation to a margin loan. Nonetheless, the effect of this conclusion in relation to margin lending and the ASIC Act is that the TPA does not apply to margin loans.

### State law

Currently each state has enacted its individual (but similar) consumer credit Act as part of an agreement to provide uniformity across the various jurisdictions.<sup>7</sup> The *Consumer Credit (Queensland) Act 1994* (Qld) (the Queensland Act), or more specifically, the Consumer Credit Code annexed to it (being the UCCC mentioned above) has been adopted by all Australian states (except WA, which has enacted its own legislation in similar terms to the other states’ legislation but without reference to the UCCC).<sup>8</sup> As mentioned earlier, **paragraph 6(1)(b)** of the UCCC states that the Code applies where ‘the credit is provided or intended to be provided wholly or predominantly for personal, domestic or household purposes’. Thus, none of the state Acts applies to margin loans which are by their nature used to finance **investment**.

Apart from the UCCC, the states have other legislation dealing with related matters such as contracts, which may be relevant to margin loans (even though they do not deal with margin lending *per se*). Industry regulations, such as the Australian Bankers’ Association’s *Code of Banking Practice* and the Australian Stock Exchange (ASX) Market Rules, may also apply, depending on who is making the loan (for example, these would apply if a banker or stockbroker provided advice in relation to a margin loan, but not if another financial service provider gave the advice).<sup>9</sup>

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6. For the text of Regulation 2B, see [http://www.austlii.edu.au/au/legis/cth/consol\\_reg/asaicr2001638/s2b.html](http://www.austlii.edu.au/au/legis/cth/consol_reg/asaicr2001638/s2b.html), viewed 17 August 2009.
  7. For the terms of the agreement, see [http://www.creditcode.gov.au/display.asp?file=/content/original\\_credit\\_code.htm](http://www.creditcode.gov.au/display.asp?file=/content/original_credit_code.htm), viewed 25 August 2009. See also the National Consumer Credit Protection Bill 2009 (and related Bills), introduced into Parliament on 25 June 2009.
  8. For the text of the Queensland Act, see [http://www.austlii.edu.au/au/legis/qld/consol\\_act/cca1994276.txt](http://www.austlii.edu.au/au/legis/qld/consol_act/cca1994276.txt), viewed 25 August 2009. For the text of the Code, see [http://www.austlii.edu.au/au/legis/qld/consol\\_act/ccc176/](http://www.austlii.edu.au/au/legis/qld/consol_act/ccc176/), viewed 25 August 2009.
  9. For further details, see Department of the Treasury, *Green Paper on Financial Services and Credit Reform*, June 2008, p. 29, viewed 25 August 2009, [http://www.treasury.gov.au/documents/1381/PDF/Green\\_Paper\\_on\\_Financial\\_Services\\_and\\_Credit\\_Reform.pdf](http://www.treasury.gov.au/documents/1381/PDF/Green_Paper_on_Financial_Services_and_Credit_Reform.pdf)

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It is therefore unhelpful to detail the various state Acts here, primarily because they really do not apply to margin loans. Further, the various state Acts are only relevant to the extent that there is no inconsistent Commonwealth law dealing with the same subject matter. In some instances, the states have referred their powers to the Commonwealth, meaning that to the extent a Commonwealth law deals with a subject referred to it by the state parliament, the state has no residual power to make law on that subject. For example, under the *Corporations (Commonwealth Powers) Act 2001* (Qld), the Queensland Parliament has referred to the Commonwealth Parliament its powers to make laws dealing with:

... the matters of the formation of corporations, corporate regulation and the regulation of financial products and services, but only to the extent of the making of laws with respect to those matters by making express amendments of the Corporations legislation (including laws inserting or amending provisions that authorise the making of Corporations instruments that affect the operation of the Corporations legislation, otherwise than by express amendment).<sup>10</sup>

This description includes the ‘regulation of financial products and services’ and yet margin loans are specifically excluded from the Corporations Act (Cth)—albeit for the present (see further below).

### Productivity Commission’s inquiry into Australia’s consumer policy framework

On 8 May 2008, the Productivity Commission released its inquiry report, *Review of Australia’s Consumer Policy Framework*.<sup>11</sup> Among other things, it made the following recommendation in relation to the gaps in the regulation of consumer credit, and suggested the following response:<sup>12</sup>

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10. Paragraph 4(1)(b).

11. The text of the final report is available electronically at <http://www.pc.gov.au/projects/inquiry/consumer/docs/finalreport>, viewed 17 August 2009.

12. Productivity Commission, *Review of Australia’s Consumer Policy Framework*, page X, [http://www.pc.gov.au/\\_data/assets/pdf\\_file/0008/79172/consumer2.pdf](http://www.pc.gov.au/_data/assets/pdf_file/0008/79172/consumer2.pdf), viewed 17 August 2009.

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Current problem	Proposed response	Main benefits of change
<p>Deficiencies of jurisdiction-based regulation of consumer credit well established.</p> <p>Gaps in the regulation of credit providers and intermediaries providing advice on credit products mean that some consumers face excessive risks and have no guaranteed access to alternative dispute resolution.</p>	<p>Transfer responsibility for regulating consumer credit to the Australian Government, with enforcement by ASIC.</p> <p>The new regime to:</p> <ul style="list-style-type: none"> <li>□ cover all credit products and intermediary services;</li> <li>□ retain the Uniform Consumer Credit Code within the broader financial services regulatory (FSR) regime;</li> <li>□ incorporate changes to regulatory requirements already agreed to by MCCA [the Ministerial Council on Consumer Affairs];</li> <li>□ incorporate other <i>appropriate</i> State and Territory credit regulation;</li> <li>□ include a licensing system for finance brokers, and a licensing or registration system for credit providers (with both requiring participation in an approved ADR scheme); and</li> <li>□ allow, over time, for streamlining of current credit regulation, given requirements in the broader FSR.</li> </ul>	<p>More effective protection for those acquiring and seeking advice on credit products.</p> <p>More timely adjustment of policy settings to changing requirements.</p>

## The Treasury's Green Paper on Financial Services and Credit Reform

In June 2008, the Treasury published its *Green Paper on Financial Services and Credit Reform* (the Green Paper).<sup>13</sup> The purpose of the Green Paper was to consult stakeholders on a range of financial services and credit reform proposals, including:

- the development of a comprehensive approach to the regulation of mortgages and mortgage broking advice
- the regulation of margin lending

13. Department of the Treasury, *Green Paper*, op. cit., p. 32.

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- the creation of a national market for trustee corporations through the implementation of Commonwealth legislation
- reforms to improve the existing regulation of debentures
- the investigation of issues relating to property investment advice, including property spruikers, and
- the consideration of the most appropriate regulation of a range of remaining credit products, such as credit cards, personal loans and micro-lending.<sup>14</sup>

The main aim of the Green Paper was to work out how best to transfer responsibility for credit control from the states to the Commonwealth. State premiers had given their ‘in-principle’ support for the transferring responsibility to the Commonwealth in March 2008—although the premiers had not agreed at that time about issues surrounding consumer debt products, such as credit cards.<sup>15</sup>

Among other things, the Treasury posed three options in relation to the future of margin lending. In relation to Option 2, which involves the amendment of Chapter 7 of the Corporations Act (and has basically found expression in the Bill), it said:

#### DISCLOSURE AND ADVICE FRAMEWORK

Defining a margin loan as a financial product will make the Chapter 7 disclosure regime applicable to margin lending products and make them subject to disclosure requirements such as the statement of advice (SOA) and product disclosure statement (PDS) requirements. The loan disclosure will need to be provided in addition to any disclosure requirements for the investment side of the margin loan product. Whether new disclosure requirements should be added into the Corporations Act disclosure regime to more closely reflect loan document requirements would need to be considered.

Within the Corporations Act, financial advice can be defined as ‘personal’ or ‘general’ advice.

The definition of general advice is broad, as it constitutes any financial product advice that is not personal advice. The definition of financial product advice includes recommendations, statements of opinion or reports of either of those things intended to influence people in making a decision about a financial product. Licensing and training requirements apply to entities providing general advice to retail clients. Bringing margin lending under the Corporations Act will help to protect retail clients who are most vulnerable to misunderstanding how a margin loan will work.

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14. Some of these issues are the subject of the current Bill, while others are the subject of the National Consumer Credit Protection Bill 2009 (and related Bills), introduced into Parliament on 25 June 2009.
  15. COAG, *Meeting Outcomes*, 3 July 2008, op cit., and D Crowe, ‘Crackdown on margin lending’, op. cit.

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## ENFORCEMENT

All margin lenders will become subject to the enforcement provisions of Chapter 7 surrounding market manipulation; false or misleading statements; inducing investors to deal using misleading information; and engagement in dishonest, misleading or deceptive conduct.

Submissions from the public on the Green Paper closed on 1 July 2008. One commentator queried the efficacy of licensing everyone involved in providing credit, including the issuers of debentures and trustees, saying: 'Just by watching ASIC's daily list of corporate crooks who lose their licences (some of whom get them back through an appeal), the Government and the community must realise that having a licence is not the entire solution'.<sup>16</sup>

Writing immediately after the release of the Green Paper in June 2008, financial journalist Elizabeth Knight emphasised the fact that under-regulated mortgage brokers and margin loan sellers make up a 'very, very small section of the community'.<sup>17</sup> She said that the 'potential to better regulate this part of the market is wonderful but it won't stop stupid or desperate punters from borrowing more than they can repay at inflated interest rates, with extortionate fees'. In Knight's opinion:

When the dust settles on the current financial crisis investment promoters will return, offering enormous yields on property, equities, debentures or ostrich eggs and a portion of the population will take the bait.

All the regulatory housekeeping in the world cannot clean up the mess made by the combination of greed and stupidity.<sup>18</sup>

### **Council of Australian Governments (COAG)**

At its meeting on 3 July 2008 (although the issue had earlier been raised at its meeting in March 2008), COAG formally agreed to transfer responsibility for the regulation of margin lending (and trustee companies) to the Commonwealth (as recommended by the Treasury in its Green Paper in June 2008):

COAG has agreed to measures that will result in better protections for financial consumers across Australia with the Commonwealth to take over responsibility for the regulation of trustee companies, mortgage broking, margin lending and non-deposit lending institutions as well as remaining areas of consumer credit. Against this background in regard to the regulation and provision of financial counselling COAG

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16. M Collins and J Durie, 'Feds must regulate consumer credit', *The Australian*, 4 June 2008, p. 40.

17. E Knight, 'Worthy reforms, but they won't stop greed', *Sydney Morning Herald*, 4 June 2008, p. 25.

18. E Knight, *op. cit.*

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agreed that the Business Regulation and Competition Working Group would examine this matter and report back in October 2008.

National regulation through the Commonwealth of consumer credit will provide for a consistent regime that extinguishes the gaps and conflicts that may exist in the current regime. The new regime is anticipated to introduce licensing, conduct, advice and disclosure requirements that meet the needs of both consumers and businesses alike. A seamless national regime will assist in ensuring that consumers are better protected in their dealings with credit products and credit providers, including brokers and advisers.<sup>19</sup>

### Basis of policy commitment: the 'Financial Services and Consumer Credit Protection Bill'

To give effect to the COAG agreement, the Rudd Government proposed to introduce the 'Financial Services and Consumer Credit Protection Bill' in the 2009 Autumn sittings of Parliament.<sup>20</sup> However, the Bill was not in fact introduced at that time.

On 13 March 2009, in delivering the Keynote Address to the National Consumer Congress in Adelaide, Senator Nick Sherry, then Minister for Superannuation and Corporate Law, provided an update on the situation, saying that the Bill, as originally proposed, would now be split into two distinct subjects: consumer credit and financial services.<sup>21</sup>

Under the two related Bills, the UCCC will become Commonwealth law, and margin lending will be covered by Chapter 7 of the Corporations Act.

### Trustee companies

Trustee companies offering traditional trustee company services are currently subject to diverse, state-based regulation. As mentioned above in the context of margin lending, COAG formally agreed at its meeting on 3 July 2008 to transfer responsibility for the regulation of trustee companies to the Commonwealth. Under the Bill, trustee companies offering traditional trustee company services will become subject to a range of licensing, conduct and disclosure requirements through the inclusion of a proposed new chapter (**proposed Chapter 5D**) in the Corporations Act.

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19. COAG, *Meeting Outcomes*, 3 July 2008, viewed 17 August 2009, [http://www.coag.gov.au/coag\\_meeting\\_outcomes/2008-07-03/index.cfm](http://www.coag.gov.au/coag_meeting_outcomes/2008-07-03/index.cfm)
  20. Department of the Prime Minister and Cabinet, 'Legislation proposed for introduction in the 2009 Autumn Sittings', viewed 25 March 2009, [http://www.dpmc.gov.au/parliamentary/docs/proposed\\_legislation.pdf](http://www.dpmc.gov.au/parliamentary/docs/proposed_legislation.pdf) (Note that this link no longer takes the reader to the document for the Autumn sittings. The link is now used to access the list of legislation proposed for introduction in the Spring 2009 sittings.)
  21. Senator Nick Sherry, then Minister for Superannuation and Corporate Law, *Keynote Address to the National Consumer Congress*, Hyatt Regency, Adelaide, 13 March 2009, viewed 24 August 2009, <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=speeches/2009/009.htm&pageID=005&min=njs&Year=&DocType=1>

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## Debentures and promissory notes

Currently promissory notes with a value of less than \$50 000 are regulated as ‘debentures’, whereas those with a value of more than \$50 000 are treated as ‘financial products’ and are not subject to the stricter debenture regulation. Apparently some financial advisers, lenders and/or investors have manipulated the current distinction between promissory notes of differing values so that they do not need to comply with consumer protection requirements under trustee arrangements. The Government is keen to close this loophole and protect ‘mum and dad investors’.<sup>22</sup>

Essentially a ‘*debenture*’ is a document that creates or acknowledges a debt. Usually an investor purchases a debenture in order to raise funds. In return for the funds, the investor pays interest to the debenture holder (lender). The debenture is subject to a trust deed.

The term ‘*debenture*’ is defined in section 9 of the Corporations Act as ‘a chose in action [or personal property right] that includes an undertaking by the body to repay as a debt money deposited with or lent to the body’. The definition also sets out what the term excludes, including (at paragraph (d)) ‘an undertaking to pay money under a promissory note that has a face value of at least \$50,000’. The term ‘*promissory note*’ is not defined in the Corporations Act, but means an ‘unconditional promise in writing made by one person to another, signed by the maker’, agreeing to pay a certain sum of money to, or to the order of, the bearer.<sup>23</sup>

Under the Bill, all promissory notes with a face value of at least \$50 000 will be included in the definition of ‘*debenture*’. This means that all promissory notes (and other debentures) will be subject to a trust deed and a trustee must be appointed to protect the investor.

Further, the Bill provides for the establishment of a public register of debenture trustees. ASIC will be responsible for the creation and maintenance of the register.

## Committee consideration

On 25 June 2009, the Bill was referred to the Senate Economics Legislation Committee as part of its inquiry into the National Consumer Credit Protection Bill 2009 and related bills.

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22. Senator Nick Sherry, then Minister for Superannuation and Corporate Law, *Safe and consistent regulation of debentures*, media release, no. 052, 7 May 2009, viewed 25 August 2009, <http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressrel%2FWA5U6%22>
  23. *Butterworths Concise Legal Dictionary*, 2004, p. 348, referring to subsection 89(1) of the *Bills of Exchange Act 1909* (Cth). The text of section 89 is available electronically at [http://www.austlii.edu.au/au/legis/cth/consol\\_act/boea1909148/s89.html](http://www.austlii.edu.au/au/legis/cth/consol_act/boea1909148/s89.html), viewed 25 August 2009.

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The committee was originally to inquire and report by 7 August 2009.<sup>24</sup> However, on 27 July 2009, the committee presented its interim report to the President of the Senate, saying it needed more time to finalise its report, which it expects to be ready by 7 September 2009.<sup>25</sup> Details of the inquiry are at [http://www.aph.gov.au/Senate/committee/economics\\_ctte/consumer\\_credit\\_09/index.htm](http://www.aph.gov.au/Senate/committee/economics_ctte/consumer_credit_09/index.htm), viewed 3 August 2009.

It should also be noted that in February 2009, the Parliamentary Joint Committee on Corporations and Financial Services resolved to inquire into the issues associated with the collapse of financial product and service providers, such as Storm Financial and Opes Prime.<sup>26</sup> It is looking at many issues connected with (or covered by) the current Bill, including the role and licensing of financial advisers, and the regulation of financial products and services (including disclosure, marketing and consumer protection). Among other issues, oral and written submissions to the committee are highlighting the enormous problems that exist at present as a result of the lack of regulation of margin lending. Particularly, they are revealing an unusual relationship between Storm Financial and the Commonwealth Bank.<sup>27</sup> The committee is not due to report before 23 November 2009, and it is not entirely clear why the current Bill was introduced into Parliament before that Committee has considered and reported on its brief.

## Financial implications

The Government will provide \$70.2 million over four years to implement the COAG decision to transfer to the Commonwealth responsibility for regulating consumer credit (including margin loans).<sup>28</sup> The funding will support the national licensing system that

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24. Selection of Bills Committee Report, Senate, *Debates*, 25 June 2009, p. 4347, viewed 3 August 2009, <http://www.aph.gov.au/hansard/senate/dailys/ds250609.pdf>
  25. Senate Economics Legislation Committee, *Inquiry into the National Consumer Credit Protection Bill 2009 and related bills: Interim Report*, 27 July 2009, viewed 3 August 2009, [http://www.aph.gov.au/Senate/committee/economics\\_ctte/consumer\\_credit\\_09/interim\\_report/report.pdf](http://www.aph.gov.au/Senate/committee/economics_ctte/consumer_credit_09/interim_report/report.pdf)
  26. Details of the inquiry are available at [http://www.aph.gov.au/Senate/committee/corporations\\_ctte/fps/index.htm](http://www.aph.gov.au/Senate/committee/corporations_ctte/fps/index.htm), viewed 3 August 2009.
  27. For details see the transcripts of the committee's public hearings, viewed 7 September 2009, [http://www.aph.gov.au/Senate/committee/corporations\\_ctte/fps/hearings/index.htm](http://www.aph.gov.au/Senate/committee/corporations_ctte/fps/hearings/index.htm) and S Washington, 'Cap'n Manny and his crazy crew', *Sydney Morning Herald*, 5 September 2009, p. 1, viewed 7 September 2009, <http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressclp%2F4CLU6%22>
  28. Explanatory Memorandum, Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009, p. 5. See also the Treasury, *2008–09 Mid-year Economic and*

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will apply to all credit providers and will also support the regulation by ASIC of mortgages, margin lending and similar financial arrangements. The funding will be partially offset by licensing fees, payable from 2009–10.<sup>29</sup>

In relation to trustee companies, the financial impact of the changes contained in the Bill is ‘expected to be absorbed in ASIC’s current budget’.<sup>30</sup> Similarly, the amendments affecting debentures are said to have ‘no significant impact’ on Commonwealth expenditure or revenue.<sup>31</sup>

## Main provisions

### Schedule 1—Margin lending facilities

**Items 2–7** amend section 761A, which is the definitions section in Chapter 7 of the Corporations Act (which deals with financial services and markets). They insert definitions of the terms ‘current LVR’, ‘limit’, ‘margin call’, ‘margin lending facility’, ‘non-standard margin lending facility’ and ‘standard margin lending facility’. These terms are defined by reference to **proposed section 761EA**, which is inserted by **item 9**.

**Item 9** inserts **proposed section 761EA** which defines the terms ‘margin lending facility’, ‘margin call’ and associated expressions. Specifically, the term ‘*margin lending facility*’ is defined in **proposed subsection 761EA(1)** to be either a ‘standard margin lending facility’, a ‘non-standard margin lending facility’ or a facility of a kind declared by ASIC to be a margin lending facility.<sup>32</sup> However, ASIC can also declare that any of these facilities is a kind of facility that is not to be a margin lending facility.<sup>33</sup>

**Proposed subsections 761EA(2), (3), (5) and (6)** go on to define the terms ‘*standard margin lending facility*’ and ‘*non-standard margin lending facility*’ and the ‘*current LVR*’ (that is, the loan-to-value ratio, discussed in the Background section above) of such facilities. The main difference between a standard margin lending facility and a non-standard one is that under a standard margin lending facility, the borrower must use the loan (in whole or in part) to acquire shares or other financial products or to refinance

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*Fiscal Outlook*, particularly ‘Part 4: Fiscal Strategy and Outlook, Appendix A: Policy Decisions Taken Since the 2008–09 Budget, Expenses Measures: Treasury’, [http://www.budget.gov.au/2008-09/content/myefo/html/appendix\\_a-22.htm](http://www.budget.gov.au/2008-09/content/myefo/html/appendix_a-22.htm), viewed 25 August 2009.

29. Explanatory Memorandum, op cit., p. 5.
30. Explanatory Memorandum, op cit., p. 6.
31. Explanatory Memorandum, op cit., p. 6.
32. **Proposed subsection 761EA(8)**.
33. **Proposed subsection 761EA(9)**.

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another margin lending facility. By comparison, in a non-standard margin lending facility, the client (borrower) receives ‘transferred property’ (which is the equivalent to credit or cash in a standard margin lending facility). The client must use the transferred property to acquire financial products. In both cases, credit must be provided to a natural person (as opposed to a corporate entity).<sup>34</sup> The term ‘*limit*’ is defined in **proposed subsection 761EA(11)** to mean the maximum amount of credit (or property) that may be provided (or transferred) by the provider to the client under the margin lending facility. If the facility is one in relation to which an ASIC declaration has been made, the ‘*limit*’ of that margin lending facility has the meaning given in the declaration.

In making a declaration under **proposed section 761EA**, ASIC must give the meanings of ‘*margin call*’ and ‘*limit*’ in relation to that kind of facility.<sup>35</sup> Any declaration made under **proposed section 761EA** must be in writing and is a legislative instrument for the purposes of the *Legislative Instruments Act 2003* (Cth).<sup>36</sup> This means that every declaration made by ASIC under **proposed section 761EA** will be subject to the parliamentary disallowance procedures in Part 5 of that Act. However, there is no criterion specified in either **proposed subsection 761EA(8)** or **(9)** setting out the matters which the ASIC must take into account in declaring if a particular kind of facility is or is not a margin lending facility.<sup>37</sup> It is also not clear how long any declaration lasts and/or if it can be revoked or varied.<sup>38</sup> Apart from matters of constitutionality, it is therefore difficult to see the basis upon which Parliament might disallow a declaration.<sup>39</sup> There might also be possible confusion in the public mind about whether a kind of facility is or is not a margin lending facility, particularly if ASIC does not keep a comprehensive list but only issues declarations on an individual basis. Further, the subtle difference between the expressions ‘person’ and ‘natural person’ may be lost on a lay user of the Corporations Act—although this is not something that is peculiar to the current Bill.

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34. Section 761A provides that for the purposes of Chapter 7 of the Corporations Act, the term ‘*person*’ has a meaning affected by section 761F (which deals with partnerships) and section 761FA (which deals with multiple trustees).

35. **Proposed subsection 761EA(8).**

36. **Proposed subsection 761EA(10).**

37. It may be that ASIC will have regard to the matters such as those set out in section 764A (as amended by the Bill) and **proposed section 985E** of the Corporations Act. (See **items 10 and 12 of Schedule 1** to the Bill.)

38. Note that subsection 33(3) of the *Acts Interpretation Act 1901* states: ‘Where an Act confers a power to make, grant or issue any instrument (including rules, regulations or by-laws) the power shall, unless the contrary intention appears, be construed as including a power exercisable in the like manner and subject to the like conditions (if any) to repeal, rescind, revoke, amend, or vary any such instrument.’

39. Sometimes Parliament will disallow a legislative instrument because it is considered to embody bad policy or be otherwise inappropriate.

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**Item 10** amends section 764A of the Corporations Act to provide that a margin lending facility is a ‘financial product’ for the purposes of Chapter 7 of the Act. This means that the provider of the margin lending facility must hold an Australian financial services licence (AFSL) under Part 7.6 of the Corporations Act.<sup>40</sup>

**Item 12** inserts **proposed Division 4A** of Part 7.8 of the Corporations Act. The proposed division contains special provisions relating to margin lending facilities. Particularly it introduces the concept of responsible lending conduct. In other words, a provider must not issue a margin lending facility to a retail client or increase the limit of an existing margin lending facility unless in the last 90 days the provider has made an assessment about whether the margin lending facility will be unsuitable for that retail client in a specified period.<sup>41</sup> The provider must also make reasonable inquiries about the client’s financial situation and take reasonable steps to verify that situation. The provider must also make any inquiries or take any steps prescribed by the regulations.<sup>42</sup>

A margin lending facility must be assessed as unsuitable if a retail client would be unable to comply with a margin call if one were made in the period covered by the assessment, or if the client could only comply with ‘substantial hardship’, or if the regulations prescribe circumstances in which a margin lending facility is unsuitable.<sup>43</sup> The phrase ‘substantial hardship’ is not defined in the Bill.

**Proposed sections 985E, 985H, 985J, 985K, 985L and 985M** are ‘civil penalty provisions’ for the purposes of existing section 1317E of the Corporations Act. If a court is satisfied that a person has contravened a civil penalty provision in the Act, then under section 1317E, the Court must make a declaration of contravention. Once a declaration has been made, ASIC can then seek a pecuniary penalty order against the person named in the declaration (section 1317G) or (in the case of a corporation/scheme civil penalty provision) ASIC can seek a disqualification order (section 206C).<sup>44</sup>

It may assist at this point to set out a table of the proposed civil penalty provisions and the issues they cover:

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40. See, particularly section 911A, which is available at [http://www.austlii.edu.au/au/legis/cth/consol\\_act/ca2001172/s911a.html](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s911a.html), viewed 26 August 2009.
  41. See also **proposed section 985F** and note the exceptions in **proposed subsection 985G(3)**.
  42. **Proposed section 985G**.
  43. **Proposed section 985H**.
  44. The text of existing section 1317E of the Corporations Act is available at [http://www.austlii.edu.au/cgi-bin/sinodisp/au/legis/cth/consol\\_act/ca2001172/s1317e.html?query=1317E](http://www.austlii.edu.au/cgi-bin/sinodisp/au/legis/cth/consol_act/ca2001172/s1317e.html?query=1317E), viewed 26 August 2009.

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Proposed section number	Issue/subject matter
Proposed section 985E	A financial services licensee (the provider of a margin lending facility) must not issue a margin lending facility to a retail client, or increase the limit of an existing margin lending facility, unless the provider has made an assessment (under <b>proposed section 985F</b> ) of the unsuitability of the margin lending facility for the client on a particular day. The provider must also make the inquiries and verification required by <b>proposed section 985G</b> (unless a financial services licensee has prepared a statement of advice for the retail client 90 days or less before the critical day etc—see <b>proposed subsection 985G(3)</b> ).
Proposed section 985H	The provider of a margin loan must assess that the margin lending facility is unsuitable for a retail client if it is likely that the facility will be unsuitable having regard to the matters set out in proposed subsection 985H(2).
Proposed section 985J	The provider of a margin lending facility must give a copy of the assessment (under <b>proposed section 985H</b> ) to the retail client on request. It may, however, be better public policy for the legislation to require the client to be provided with the assessment as a matter of course.
Proposed section 985K	The provider of a margin lending facility must not issue an unsuitable margin lending facility to a retail client or increase the limit on a margin lending facility that was issued to the client.
Proposed section 985L	The provider of a margin lending facility must not require, as a condition of issuing the facility, that the retail client agrees to receive communications through an agent. (See <b>proposed subsection 985M(2)</b> .)

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Proposed section 985M	<p>The provider must take reasonable steps to notify a retail client of a margin call. If there is an agreement between the provider, the retail client and another financial services licensee (an agent) that the agent will receive communications from the provider in relation to the margin lending facility on behalf of the retail client, then the provider must take reasonable steps to notify the agent (instead of the retail client) of the margin call. However, the agent must also take reasonable steps to notify the retail client of the margin call too.</p> <p>ASIC may determine when the notice must be given, but if ASIC does not determine any time frame, then the notice must be given as soon as practicable. The notice must be given in the manner agreed between the provider and the agent and/or retail client. If no manner is agreed, then the notice must be given in the manner determined by ASIC. In the absence of any such determination by ASIC, then the notice must be given in a reasonable manner. Any determination made by ASIC under this section must be made in writing and is a legislative instrument for the purposes of the <i>Legislative Instruments Act 2003</i> (Cth). It will thus be subject to the parliamentary disallowance procedures in Part 5 of that Act.</p>
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**Item 13** amends existing subsection 1016A(1) of the Corporations Act to include a margin lending facility in the list of ‘relevant financial products’ to which the section applies. The section deals with the use of application forms in the context of product disclosure statements. Similarly, **item 14** amends existing subsection 1017D(1) to include a margin lending facility in the list of financial products (having an investment component) for which the issuer of the product must provide the retail client with a periodic statement (showing the opening and closing balance and any transactions made in relation to the investment during the relevant period).

**Item 15** amends existing subsection 1317E(1) to include the relevant parts of **proposed sections 985E, 985H, 985J, 985K, 985L and 985M** as civil penalty provisions. (See table above for a summary of these proposed sections.)

**Item 16** amends Schedule 3 to the Corporations Act to set the maximum penalty for contravening **proposed subsections 985J(1), (2) or (4)** at 50 penalty units.<sup>45</sup> It also sets

45. Note that under section 4B of the *Crimes Act 1914*, the maximum penalty is increased fivefold for corporations. See

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the penalty for contravening **proposed subsection 985K(1)** at 100 penalty units, or imprisonment for 2 years, or both.<sup>46</sup>

## Schedule 2—Trustee companies

**Schedule 2** to the Bill deals with trustee companies. Among other things, it inserts **proposed Chapter 5D** into the Corporations Act, dealing with licensed trustee companies. It contains numerous complex provisions. However, instead of discussing them all, the Digest will provide a summary and/or brief comment on the most significant aspects of the chapter.

**Items 1 and 2** of Schedule 2 to the Bill amend existing subsection 12BA(1) of the ASIC Act to insert definitions for the terms ‘traditional trustee company services’ and ‘trustee company’. These terms are defined by cross-reference to the meanings of these terms in Chapter 5D of the Corporations Act. That chapter does not exist at present but is to be inserted by **item 9** of Schedule 2 to the Bill. It will deal with licensed trustee companies.

**Item 6** amends existing section 283AC of the Corporations Act to provide that a licensed trustee company (within the meaning of **proposed Chapter 5D**) can be a trustee for the purpose of the issuing of debentures.

**Items 7 and 8** amend section 490, which provides that except with the leave of the Court, a company cannot resolve that it be wound up voluntarily if an application for the company to be wound up in insolvency has been filed, or the Court has ordered that the company be wound up in insolvency (whether or not the order was made on such an application). The Bill proposes to add the stipulation that a company cannot resolve to be wound up voluntarily if the company is a trustee company (as defined in **proposed section 601RAB**) that is in the course of administering or managing one or more estates. Further, any ‘person with a proper interest’ (as defined in **proposed section 601RAD**) in a relevant estate is entitled to be heard in a proceeding before the Court for leave under subsection 490(1).

**Item 9** inserts **proposed Chapter 5D**, dealing with licensed trustee companies. It comprises **proposed sections 601RAA to 601YAB**.

## Proposed Chapter 5D—Licensed trustee companies

**Proposed Part 5D.1** sets out preliminary issues in proposed Chapter 5D.

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[http://www.austlii.edu.au/au/legis/cth/consol\\_act/ca191482/s4b.html](http://www.austlii.edu.au/au/legis/cth/consol_act/ca191482/s4b.html), viewed 7 September 2009. (This comment applies equally to other penalties mentioned in this Digest.)

46. A ‘penalty unit’ is defined in subsection 4AA(1) of the *Crimes Act 1914* (Cth) as \$110. Fifty penalty units is therefore \$5500, and 100 penalty units is \$11 000.

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For example, **proposed section 601RAB** defines the terms ‘trustee company’ and ‘client’ [of a trustee company]. A ‘*trustee company*’ is a corporation to which paragraph 51(xx) of the Constitution applies and that is prescribed by the regulations as a trustee company for the purposes of the Corporations Act.<sup>47</sup> **Proposed subsection 601RAB(2)** states that companies may be prescribed by setting out a list of companies in the regulations or by ‘providing a mechanism in the regulations for the determination of a list of companies’. While the first method has the advantage of attracting the disallowance procedures in Part 5 of the *Legislative Instruments Act 2003*, the second method may not. The term ‘*client*’ is defined as a person to whom a financial service (being a ‘traditional trustee company service’) is provided by the trustee company (within the meaning of Chapter 7 of the Corporations Act).

The terms ‘traditional trustee company service’ and ‘estate management functions’ are defined in **proposed section 601RAC**. The following are ‘*traditional trustee company services*’:

- (a) performing estate management functions (see subsection (2));
- (b) preparing a will, a trust instrument, a power of attorney or an agency arrangement;
- (c) applying for probate of a will, applying for grant of letters of administration, or electing to administer a deceased estate;
- (d) establishing and operating common funds;
- (e) any other services prescribed by the regulations for the purpose of this paragraph.

The term ‘*estate management functions*’ includes acting as a trustee; acting as an executor or administrator of a deceased estate; and acting as a receiver, controller or custodian of property. However, **proposed subsection 601RAC(3)** then sets out what is not a ‘traditional trustee company service’ or ‘estate management function’, including operating a registered scheme; providing a custodial or depository service; acting as a trustee for debenture holders; and acting as trustee of a superannuation fund (within the meaning of the *Superannuation Industry (Supervision) Act 1993*).

**Proposed section 601RAD** defines the term ‘*person with a proper interest*’ (in relation to an estate) to include the following:

- ASIC

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47. Paragraph 51(xx) of the Constitution provides that the Commonwealth Parliament has, subject to other provisions in the Constitution, power to make laws with respect to ‘foreign corporations, and trading or financial corporations formed within the limits of the Commonwealth’.

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- a settlor of a charitable trust; a person who has power under the terms of the trust to appoint or remove a trustee; or a state or territory Minister who has responsibilities relating to charitable trusts; a person named in the trust instrument as being able to receive payments on behalf of the trust; a person who under the terms of the trust must be consulted before the trustee distributes money or other property under the trust; or a person of a class whom the trust is intended to benefit
- a beneficiary under the deceased person's will (or if the person died intestate, a person who has an interest in the deceased's estate under state or territory law)
- a settlor of a trust other than a charitable trust; a person who has power under the terms of the trust to appoint or remove a trustee; or a beneficiary of the trust
- any person prescribed by the regulations as having a proper interest in the estate, and
- an agent of any person mentioned above who is under a legal disability.

**Proposed section 601RAE** deals with the interaction between 'trustee company provisions' in the Corporations Act and state and territory laws.<sup>48</sup> Essentially the trustee company provisions are intended to apply to the exclusion of state or territory laws that do the following things:

- authorise or license companies to provide traditional trustee company services generally
- regulate the fees that companies may charge for the provision of traditional trustee company services
- deal with the provision of accounts by companies in relation to traditional trustee company services they provide
- deal with the duties of officer or employees of companies that provide traditional trustee company services
- regulate the voting power that people may hold in companies that provide traditional trustee company services, or that impose restrictions on the ownership or control of companies that provide such services, or
- deal with the disposal of the assets and liabilities held by a company that ceases to be licensed or authorised to provide traditional trustee company services.

The trustee company provisions are not intended to apply to the exclusion of state or territory laws that require a company to have particular qualifications or experience if the company is to provide traditional trustee company services of a particular kind. However, **proposed subsection 601RAE(4)** states that the regulations may provide that the trustee

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48. The term 'trustee company provisions' is defined in **proposed subsection 601RAE(1)** as the provisions of **proposed Chapter 5D** and existing Chapter 7, and regulations or other instruments made for the purposes of those chapters.

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company provisions are, or are not, intended to apply to the exclusion of prescribed state or territory laws (or prescribed provisions thereof). For the avoidance of doubt, **proposed subsection 601RAE(6)** states that Part 1.1A of the Corporations Act does not apply in relation to the trustee company provisions.<sup>49</sup>

**Proposed Part 5D.2** deals with the powers and functions (etc) of licensed trustee companies, and related issues such as the jurisdiction of courts.

**Proposed section 601SAA** states that any inherent power or jurisdiction of courts in relation to the supervision of the performance of traditional trustee company services is not affected by anything in **proposed Chapter 5D**.

**Proposed section 601SAB** states that the regulations may prescribe powers, functions, liabilities, obligations, privileges and immunities that a licensed trustee company has in relation to the provision of traditional trustee company services.

**Proposed section 601SAC** states that the powers, functions (etc) conferred by or under **proposed Chapter 5D** are in addition to any powers, functions (etc) conferred or imposed by any other law on trustee companies or persons who perform estate management functions or other traditional trustee company services.

**Proposed subsection 601SBA(1)** states that a licensed trustee company, acting alone in relation to the estate of a deceased person, is not required to file (or file and pass) accounts relating to the estate unless ordered to do so by a court. However, under **proposed subsection 601SBA(2)**, if the licensed trustee company acts jointly with another person in relation to the estate of a deceased person, then the trustee company and that other person are not required to file (or file and pass) accounts relating to the estate unless the other person intends to charge fees for acting in relation to the estate or the Court orders it to do so.

**Proposed section 601SBB** provides that the licensed trustee company must provide, on application by a person with a proper interest in an estate administered on managed by the company, an account of the following matters:

- the assets and liabilities of the estate
- the trustee company's administration and management of the estate
- any investment made from the estate
- any distribution made from the estate, and
- any other expenditure (including fees and commissions) from the estate.

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49. Part 1.1A of the Corporations Act deals with the interaction between corporations legislation and state and territory laws. Specifically, section 5E states that concurrent operation is intended.

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Failure to provide the account is an offence.<sup>50</sup> However, the trustee company does not need to provide any such accounts at less than three monthly intervals.<sup>51</sup> It may charge a reasonable fee for providing the account.<sup>52</sup> If the trustee company fails to provide a proper account, the person who sought the account (or another person with a proper interest in the estate) may apply to the Court for any order that the Court considers appropriate, ‘including an order requiring the preparation and delivery of proper accounts’.<sup>53</sup> However, apart from stipulating the matters referred to in **proposed subsection 601SBB(1)**, it is not clear what level of detail is required for an account to be considered to be ‘proper’. In addition to, or in substitution for any account that it may order under **proposed section 601SBB**, the Court may also order an audit of the trustee company’s accounts that relate to the relevant estate.<sup>54</sup>

**Proposed section 601SCA** states that a licensed trustee company may, for investment purposes, pool money from two or more estates under its administration. The fund into which the money is pooled is called a ‘common fund’.<sup>55</sup> The common fund may also include other money,<sup>56</sup> however, the trustee company cannot put estate money into a common fund if it is expressly prohibited by the conditions on which the estate money is held on trust by the company.<sup>57</sup> Where a trustee company holds more than one common fund, each common fund must be allocated a distinguishing number.<sup>58</sup> The trustee company must keep accounts showing at all times the current amount at credit in the fund on account of each estate.<sup>59</sup>

**Proposed Part 5D.3** deals with the regulation of fees charged by licensed trustee companies and related issues.

For example, under **proposed section 601TAA**, a licensed trustee company must ensure that an up-to-date schedule of the fees it generally charges for providing traditional trustee

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50. See section 1311 which sets out the general penalty provisions in the Corporations Act. **Item 26** of Schedule 2 to the Bill amends section 1311 to include reference to Chapter 5D, and **item 28** of Schedule 2 to the Bill amends Schedule 3 to the Corporations Act to set the penalty for contravention of **proposed section 601SBB** at 50 penalty units.

51. **Proposed subsection 601SBB(2)**.

52. **Proposed subsection 601SBB(3)**.

53. **Proposed subsection 601SBB(4)**.

54. **Proposed subsection 601SBC(1)**.

55. **Proposed subsection 601SCA(2)**.

56. **Proposed subsection 601SCA(3)**.

57. **Proposed subsection 601SCB(3)**.

58. **Proposed subsection 601SCB(1)**.

59. **Proposed subsection 601SCB(2)**.

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company services is published at all times on its website and available free-of-charge at the company's office during usual opening hours.

If, while providing a service to a particular client, the company changes the fees it will charge for the provision of the service, the company must (if requested) send the client a copy of the revised fees within 21 days of the change taking effect, or (in any other case) it must notify the client directly in writing that the changed fees are available on the internet at a specific website maintained by or on behalf of the company.<sup>60</sup>

A licensed trustee company may charge fees for providing traditional trustee company services,<sup>61</sup> including any fees that a testator in his or her will has directed to be paid, or any fees that have been agreed between the trustee company and any person having the authority to deal with the company.<sup>62</sup> If the licensed trustee company performs an estate management function, then ordinarily any fees payable to the trustee company are to be paid out of the capital or income of the relevant estate.<sup>63</sup>

If the licensed trustee company becomes the trustee or manager of a charitable trust after the commencement of **proposed section 601TDA**, then the trustee company must only charge either a capital commission and an income commission, or an annual management fee.<sup>64</sup> However, the company can also charge common fund administration fees and any fees permitted under the Corporations Act for the preparation of returns, if applicable in the circumstances.<sup>65</sup>

If the Court is of the opinion that fees charged by a licensed trustee company are excessive, it may review the fees and may also reduce them.<sup>66</sup> In considering if the fees are excessive, the Court may consider matters such as:

- the extent to which the work performed by the trustee company was or is likely to be 'reasonably necessary'

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60. **Proposed section 601TAB.**

61. **Proposed section 601TBA.**

62. **Proposed section 601TBB.**

63. **Proposed section 601TBE.** A management fee payable under **proposed section 601TDD** can only come out of the income of the relevant estate, and a common fund administration fee mentioned in **proposed sections 601TDE and 601TDI** can only come out of the income received by the common fund on the assets of the charitable trust concerned.

64. **Proposed section 601TDB.** The formulae for calculating these commissions and management fee are set out in **proposed sections 601TDC and 601TDD.**

65. **Proposed paragraphs 601TDB(1)(b) and (c).** See also **proposed sections 601TDE and 601TDF** for more specific details about charging such fees.

66. **Proposed section 601TEA.** The Court does not hold this power where the fees are agreed between the company and the client or another person, or relate to a charitable trust.

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- the period during which the work was, or is likely to be, performed, and
- the quality and complexity of the work.

An employee of a licensed trustee company must not make use of information acquired through his or her position for the purpose of gaining an improper advantage for himself or herself or another person. The employee must also not use the information it to cause detriment to the clients of the trustee company.<sup>67</sup>

**Proposed Part 5D.4** (that is, **proposed sections 601UAA and 601UAB**) sets out the duties of officers and employees of licensed trustee companies. They are the usual sorts of duties expected from officers in other arenas, such as acting honestly, exercising due care and diligence, and not making use of information gained from the position for improper personal purposes. Failure to comply with the relevant provision is an offence.<sup>68</sup> Any person who contravenes or is ‘involved’ in the contravention of the relevant duties contravenes **proposed subsection 601UAA(2)** or **proposed subsection 601UAB(2)**. These are designated as ‘civil penalty provisions’ for the purposes of section 1317E of the Corporations Act.<sup>69</sup>

**Proposed Part 5D.5** sets a 15 per cent voting limit on the control of licensed trustee companies.

An ‘*unacceptable control situation*’ exists where any person (or two or more persons acting under an arrangement) holds more than 15 per cent of voting power in the company.<sup>70</sup> If an ‘unacceptable control situation’ comes into existence (or already exists) in relation to the trustee company and the particular person, then the person (or persons) contravene **proposed section 601VAB**. Such contravention is an offence under existing section 1311 of the Corporations Act (see above). If an ‘unacceptable control situation’

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67. **Proposed section 601UAB.**

68. As noted above, section 1311 sets out the general penalty provisions in the Corporations Act. **Item 28 of Schedule 2** to the Bill amends Schedule 3 to the Corporations Act to set the maximum penalty for contravening **proposed subsection 601UAA(1) or 601UAB(1)** at 300 penalty units or 5 years’ imprisonment or both.

69. If a court is satisfied that a person has contravened a civil penalty provision in the Act, then under existing section 1317E, the Court must make a declaration of contravention. Once a declaration has been made, ASIC can then seek a pecuniary penalty order against the person named in the declaration (section 1317G) or (in the case of a corporation/scheme civil penalty provision) ASIC can seek a disqualification order (section 206C).

70. **Proposed section 601VAA.** This figure can be higher if approval is in force under proposed Division 2 of **proposed Part 5D.5** in relation to the particular company and for the particular person to hold a higher percentage.

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exists, the Court may make appropriate orders to end the situation.<sup>71</sup> Only a limited range of persons has standing to apply to the Court for such orders:

- the Minister
- ASIC
- the trustee company
- a person who has voting power in the company, or
- a client of the trustee company.

A person who wishes to have more than 15 per cent of voting power in a particular licensed trustee company may apply to ASIC for approval to exceed the 15 per cent limit.<sup>72</sup> ASIC must give the application to the Minister, who may grant the application if he or she is satisfied that it would be in the interests of the licensed trustee company and its clients for the application to be granted. If the Minister grants the application, he or she must specify in writing the percentage of voting power the Minister approves (which need not be the percentage specified in the application).<sup>73</sup> A copy of the notice of approval must be published in the *Gazette* and given to the licensed trustee company.<sup>74</sup>

Any approval of an application to exceed the 15 per cent voting power limit remains in force for the period specified in the notice of approval (or if the Minister extends the approval, then for any extended period). If the notice of approval does not specify a time limit, the approval remains in force indefinitely.<sup>75</sup> Any approval is subject to such conditions as are specified in the notice of approval.<sup>76</sup> Any condition may be varied or

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71. **Proposed section 601VAC.** The orders may include an order directing the disposal of shares, restraining the exercise of any rights attached to the shares, and an order directing a person to do or refrain from doing a specified act. The order must not result in the acquisition of property from a person other than on just terms, and the order must not be invalid because of paragraph 51(xxxi) of the Constitution (which provides that the Commonwealth has power to make laws for the acquisition of property by the Commonwealth on just terms from any state or person for any purpose in respect of which the Commonwealth has power to make laws): **proposed section 601VCA.**
72. **Proposed section 601VBA.**
73. **Proposed section 601VBB.** Note that under **proposed section 601VBE**, a person who holds an approval under **proposed section 601VBB** may apply to vary the percentage specified in the approval by lodging another application with ASIC for the Minister's approval.
74. **Proposed subsection 601VBB(4).**
75. **Proposed section 601VBC.**
76. The conditions must also be published in the *Gazette* and given to the licensed trustee company concerned: **proposed subsection 601VBD.**

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revoked—either on the Minister’s own initiative or on application by the person who holds the approval.<sup>77</sup>

The Minister may revoke an approval if he or she is satisfied that:

- it would be in the interests of the trustee company and its clients for the approval to be revoked
- an unacceptable control situation exists in relation to the trustee company and in relation to the person, or
- there has been a contravention of a condition

The Minister must make a decision on an application under **proposed Division 2 of proposed Part 5D.5** within 30 days of receiving the application. Within that period, the Minister may decide to extend the period to 60 days. If the Minister does not make a decision within the relevant time period, the Minister is taken to have granted whatever was applied for.<sup>78</sup>

If one or more persons enter into, begin to carry out or in fact successfully carry out a scheme and the sole or dominant purpose of the scheme was to avoid the application of the 15 per cent voting limit rule, then the Minister may give the scheme’s controller a written direction to cease having that voting power within a specified time: **proposed section 601VCC**. The direction is not a legislative instrument, and therefore cannot be subject to parliamentary disallowance. It could, however, be challenged under the *Administrative Decisions (Judicial Review) Act 1977*.

**Part 5D.6** sets out the consequences of cancelling an Australian financial services licence.

**Proposed section 601WAA** contains definitions of terms used elsewhere in the proposed Part, including ‘asset’, ‘authorised ASIC officer’, ‘certificate of transfer’ and ‘compulsory transfer determination’. The term ‘cancel’ is defined to mean cancelling the licence under Part 7.6 of the Corporations Act or varying the conditions of the licence under that part (so that the licence ceases to cover traditional trustee company services).

If ASIC cancels the licence of a trustee company, then ASIC may also determine in writing that the company’s estate assets and liabilities are to be transferred to another licensed trustee company.<sup>79</sup> Before ASIC makes the determination:

- the Minister must usually consent to the transfer,<sup>80</sup> or

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77. **Proposed section 601VBD**. The application is made to ASIC who must give it to the Minister as soon as possible.

78. **Proposed section 601VBI**.

79. **Proposed section 601WBA**, which deals with compulsory transfer determinations.

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- ASIC must be satisfied that the transfer is in the interests of the clients of the transferring company (when viewed as a group) and in the interests of the clients of the receiving company (when viewed as a group).

Also, the board of the receiving company must consent to the transfer, and relevant legislation to facilitate the transfer must be enacted by the state or territory in which the transferring and receiving companies are registered.<sup>81</sup>

A compulsory transfer determination may impose conditions that are to be complied with by the transferring or receiving company before ASIC issues a certificate of transfer. It may also impose conditions that are to be complied with by the transferring or receiving company after the certificate has been issued or come into force.<sup>82</sup> The conditions may be varied or revoked at a later time, and any receiving company that is complying with a condition that would otherwise breach the Corporations Act does not commit an offence.<sup>83</sup> ASIC must give a copy of the determination to the transferring company and the receiving company.<sup>84</sup> If ASIC has made a compulsory transfer declaration and it considers the transfer should go ahead, and the relevant consent has not been withdrawn, then ASIC must issue a written certificate of transfer stating that the transfer is to take effect.<sup>85</sup>

The transferring company must (on request) give the receiving company access to all books in its possession that relate to the assets or liabilities transferred to the receiving company.<sup>86</sup> If the transferring company receives any income or other distribution from

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80. Under **proposed section 601WBD**, the Minister may determine in writing that his or her consent is not required in relation to a particular transfer or a class of transfer that includes the transfer in question. The regulations may prescribe criteria to be taken into account by the Minister in deciding whether to make a determination. The determination is a legislative instrument only if it is expressed to apply in relation to a class of transfers.
81. See also **proposed section 601WBC**, which deals with complementary state or territory legislation that must provide that the receiving company is taken to be the successor in law in relation to the estate assets and liabilities of the transferring company to the extent of the transfer. Presumably such legislation can specify that the receiving company is not responsible for the payment of stamp duty that would otherwise be payable on the transfer of certain assets, particularly land. See also in this regard **proposed section 601WCB**, which deals with certificates in relation to land and interests in land.
82. **Proposed section 601WBE.**
83. **Proposed subsections 601WBE(2) and (6).**
84. **Proposed section 601WBF.**
85. **Proposed section 601WBG.**
86. **Proposed section 601WCG.**

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assets transferred to the receiving company after the certificate of transfer comes into force, it must promptly account to the receiving company for the income.<sup>87</sup>

If the licence of a trustee company is cancelled, the trustee company must as soon as practicable contact:

- all persons who the trustee company is aware have executed and lodged instruments (such as wills) that have not yet come into effect but may cause the company to hold estate assets and liabilities
- all persons who the trustee company is aware have appointed it as trustee (or some other capacity).<sup>88</sup>

The trustee company must also publish notice of the cancellation of the licence.<sup>89</sup>

**Proposed Part 5D.7** sets out the effect of contravening **proposed Chapter 5D**.

If a person suffers loss or damage because of conduct by the licensed trustee company that contravenes **proposed Chapter 5D**, then he or she may recover the amount of the loss or damage by bringing a civil action against the trustee company. The trustee company does not need to have been convicted of an offence or have had a civil penalty order made against it in respect of the contravention.<sup>90</sup>

Finally, **proposed Part 5D.8** provides for exemptions and modifications in the operation of **proposed Chapter 5D**.

For example, ASIC may exempt a person or class of persons, or an estate or class of estate from all of specified provisions of **proposed Chapter 5D**.<sup>91</sup> The exemption may apply unconditionally or subject to specified conditions. ASIC may also declare that **proposed Chapter 5D** applies to a person or class of person, or an estate or class of estates, as if specified provisions were omitted, modified or varied as specified in the declaration.<sup>92</sup>

Any declaration or exemption made under **proposed section 601YAA** is a legislative instrument if it is expressed to apply in relation to a class of persons or a class of estates. Otherwise the declaration or exemption is not a legislative instrument but must be published in the *Gazette*.

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87. **Proposed section 601WCF.**

88. **Proposed section 601WDA.**

89. **Proposed paragraph 601WDA(1)(b).**

90. **Proposed section 601XAA.**

91. **Proposed paragraph 601YAA(1)(a).**

92. **Proposed paragraph 601YAA(1)(b).**

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If conduct (including an omission) would constitute an offence if a particular declaration has not been made, that conduct does not constitute an offence unless, before the conduct occurred, the text of the declaration was made available by ASIC on the internet or ASOC gave written notice setting out the text of the declaration to the person whose conduct would otherwise constitute an offence.<sup>93</sup>

Further, **proposed section 601YAB** provides that the regulations may also exempt a person or class of persons, or an estate or class of estates, from all or specified provisions of **proposed Chapter 5D**. They may also provide that **proposed Chapter 5D** applies to a person or class or persons, or an estate or class of estates, as if the specified provisions were omitted, modified or varied as specified in the declaration.

### **Miscellaneous provisions in Schedule 2**

**Items 10 to 14 of Schedule 2** amend or insert definitions into existing section 761A, which as mentioned above is the definitions section in Chapter 7 of the Corporations Act. They make clear that **proposed Chapter 5D** (see **item 9** above) is part of the definition of the term ‘*financial services law*’. They also state that the terms ‘*licensed trustee company*’, ‘*traditional trustee company services*’ and ‘*trustee company*’ have the same meaning in Chapter 7 as they do in **proposed Chapter 5D**.

**Items 15 to 25** make consequential amendments to existing provisions in the Corporations Law to make it clear whether or not those existing provisions apply following the enactment of the amendments contained in **Schedule 2** to the Bill, particularly **proposed Chapter 5D** of the Corporations Act.

**Item 26** inserts reference to **proposed Chapter 5D** in existing paragraph 1311(1A)(d) of the Corporations Act. As mentioned above, that section deals with general penalty provisions in the Act. If a person does an act or thing that the person is forbidden to do by or under a provision of the Act, or does not do an act or thing that the person is required or directed to do by or under a provision of the Act, or otherwise contravenes a provision of the Act, then the person is only guilty of an offence under section 1311 unless another provision of the Act says that he or she is guilty (or not guilty) of an offence under that other provision. However, in order to be guilty of an offence under section 1311, the penalty (‘pecuniary or otherwise’) for a provision listed in section 1311(1A) must be set out in Schedule 3 to the Corporations Act. To this end, **item 26** inserts reference to **proposed Chapter 5D** in existing subsection 1311(1A), and **item 28** amends Schedule 3 to the Corporations Act to include penalties for 18 offences contained in **proposed Chapter 5D**. The penalties range from 50 penalty units (for offences like failing to provide proper accounts) to 300 penalty units or imprisonment for 5 years or both (for breach of duties owed by employees or officers of licensed trustee companies).

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93. **Proposed subsection 601YAA(5).**

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### Schedule 3—Debentures

**Item 1 of Schedule 3** to the Bill repeals paragraph (d) of the definition of the term ‘*debenture*’ in section 9 of the Corporations Act in order to remove the current distinction between promissory notes worth less than \$50 000 (which are currently regulated as debentures) and those worth at least \$50 000 (which fall outside the current definition of ‘debenture’).

**Item 2** repeals existing section 283BC and replaces it with a revised provision setting out the duty of a borrower to notify ASIC of certain information related to the trustee.<sup>94</sup>

**Item 3** inserts **proposed section 283BCA** to provide that ASIC must establish and maintain a register relating to trustees for debenture holders. The regulations may prescribe the way in which the register is to be established or maintained, including the details that ASIC must enter in the register. A person may inspect and make copies of the register, subject to the payment of any fee prescribed by the regulations.

### Schedule 4—Technical amendment

**Schedule 4** only contains one item which amends existing subsection 1338B(8) to insert reference to ‘the Capital Territory’.<sup>95</sup> The existing omission is clearly an oversight, given the reference in other parts of section 1338B not only to a court ‘of a State’ or ‘the Northern Territory’ but also ‘the Capital Territory’.

### Schedule 5—Application and transitional provisions

**Schedule 5** only contains one item too. **Item 1** inserts **proposed Part 10.12** into Chapter 10 of the Corporations Act, which contains transitional provisions for the Act. The proposed part sets out transitional provisions relating to the current Bill once enacted.

For example, the amendments made by **Schedule 1** to the Bill will apply in relation to a margin lending financial service that is provided on or after the day that is 12 months after the commencement of the schedule.<sup>96</sup> However, before that day, a person may apply to ASIC for an Australian financial services licence that authorises the person to provide a margin lending financial service.<sup>97</sup> A person may also apply to ASIC for a variation of a

94. Section 283BC appears in Chapter 2L of the Corporations Act, which deals with debentures. Specifically, it appears in Part 2L.2 which sets out the duties of a borrower. (Part 2L.1 establishes the requirement for a trust deed and a trustee in relation to the debenture.)

95. Section 1338B deals with the criminal jurisdiction of state and territory courts.

96. **Proposed section 1488.** Note that **Schedule 2** to the Bill is due to commence on a single day to be fixed by proclamation, or 6 months and one day after the Act receives Royal Assent, whichever occurs first: **clause 2** of the Bill.

97. **Proposed paragraph 1489(2)(a).** See also **proposed section 913A.**

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condition of an Australian financial services licence to authorise the person to provide a margin lending financial service.<sup>98</sup>

In effect this means that a person may apply for an Australian financial services licence (or a condition or a variation) immediately after the commencement of Schedule 1, and ASIC may grant the licence, but the licence (or condition or variation) will not take effect until 12 months after the commencement of Schedule 1.<sup>99</sup> After that date, it will be mandatory to apply for and hold an Australian financial services licence in order to provide a margin lending financial service in Australia.

## Concluding comments

The Bill contains many complex and technical provisions that are necessary to enable the Commonwealth to regulate the providers of margin lending and traditional trustee company services as effectively as other parts of the financial services sector.

The Bill gives effect not only to the recommendation of the Productivity Commission for better regulation of credit providers but also to the COAG decision to transfer the regulation of margin lending and trustee companies from the states to the Commonwealth. It also gives effect to the option preferred by the Treasury (following extensive public consultation on its *Green Paper on Financial Services and Credit Reform*) to include margin lending as a financial product for the purposes of Chapter 7 of the Corporations Act.

It is not entirely clear why the current Bill was introduced into Parliament before the Parliamentary Joint Committee on Corporations and Financial Services inquires into and reports on the issues associated with the collapse of financial product and service providers, such as Storm Financial and Opes Prime. It is, however, noted that the committee's report is not (at this stage) due before 23 November 2009 (some five months after the Bill was introduced).

On the other hand, the fact that the parliamentary committee is yet to report should not of itself be a reason to delay the proper regulation of the providers of margin lending financial services and trustee companies providing traditional trustee company services, particularly as the relevant provisions in the Bill do not commence on Royal Assent. It is always open to the committee to recommend further changes to the Corporations Act and/or the ASIC Act.

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98. **Proposed paragraph 1489(2)(b).** See also **proposed section 914A.**

99. **Proposed subsection 1489(3).**

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