Australian Government

The Treasury

SENATE STANDING COMMITTEE ON ECONOMICS

TREASURY SUBMISSION

CORPORATIONS LEGISLATION AMENDMENT (FINANCIAL SERVICES MODERNISATION) BILL 2009

AUGUST 2009

OVERVIEW

On 25 June 2009, the Australian Government introduced the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009 (Modernisation Bill)) into Parliament to give effect to a Council of Australian Governments (COAG) commitment to regulate margin lending and trustee companies at the national level, and to enhance the regulation of debentures.

MARGIN LOANS

Background

General

A margin loan facility allows an investor to borrow money to invest in securities and other financial products against the security of any equity contribution, usually in the form of financial products.

Depending on the margin lending product and the provider, securities and other financial products may include listed shares, fixed interest securities and units in managed funds. In practice, margin loans are usually only available to fund purchases of 'approved' securities that the lender regards as acceptable from a risk and liquidity perspective.

There are currently about 189,000 margin loans outstanding in Australia with a total value of $18.7 billion. This is a significant drop from the maximum number of 206,000 loans reached in June 2008, and the maximum value of outstanding margin loans reached in December 2007 of $37.8 billion. This fall is likely to be attributable to the current weakness in share markets. Margin loan numbers and values may be expected to increase again once share markets recover.

Over the past year (from March 2008 to March 2009) there has been a net fall of 13,000 in the number of margin loans. The previous three years (starting in March 2005) all had net gains of 10,000, 24,000 and 32,000 loans respectively.

Regulation

Currently, margin lending facilities are not regulated as a financial product, or subject to Australian Securities and Investments Commission (ASIC) supervision relating to financial services. This is because the term 'financial product' in the relevant legislation does not cover credit products (such as margin loans) as a result of the current referral agreement with the States and Territories.

Further, State and Territory legislation governing consumer credit (the Uniform Consumer Credit Code) excludes investment loans such as margin lending. However, there are some regulatory measures which capture aspects of the margin lending product. This includes the Australian Securities and Investments Commission Act 2001 (ASIC Act) which gives prohibits unconscionable as well as misleading and deceptive conduct with respect to financial services. For the purpose of the ASIC Act, credit facilities (which include margin loans) are financial products and are subject to general consumer protection provisions, such as those relating to misleading and deceptive conduct. As margin loans are supplied by a variety of providers, including banks and stockbrokers, various industry regulations may also apply, including, for example, the Code of Banking Practice.

The Council of Australian Governments (COAG) reached an in principle agreement on 26 March 2008 that the Australian Government would assume responsibility for regulating mortgage credit and advice, margin loans and trustee companies. The Corporations Legislation Amendment (Financial Services Modernisation) Bill 2001 (the Bill) has since been introduced into Federal Parliament on 25 June 2009 which inserts margin loans into the existing regulatory framework for financial products and services in Chapter 7 of the Corporations Act 2001 (the Corporations Act).

Why margin loans are inserted into Chapter 7 of the Corporations Act

As stated above, margin loans have been included as a financial product in Chapter 7 of the Corporations Act 2001 (Corporations Act). Chapter 7 regulates the provision of financial services supplied in relation to financial products (which are primarily of an investment nature). As margin loans are a form of credit widely used to finance acquisitions of investment-related financial products, Chapter 7 is considered to provide a range of appropriate regulatory settings for margin loans.

In particular, Chapter 7 provides an investor protection regime for financial products and services. It requires that persons providing financial services and products must, among other things:

- ensure that they have adequate resources and are competent to provide the services. They must also ensure that their representatives are adequately trained and competent to provide the services;
- obtain an Australian financial services licence (AFSL) from ASIC;
- comply with general conduct standards, including the requirement to deal with investors efficiently, honestly and fairly;
- have appropriate compensation arrangements in place for losses suffered by retail clients due to breaches of the law. This includes membership of an ASIC approved External Dispute Resolution scheme;
- provide appropriate disclosure to their retail clients before and after a product is purchased, including providing a financial services guide, product disclosure statement, statement of advice as well as periodic statements on an ongoing basis;
- have in place adequate arrangements for the management of conflicts; and
- be subject to supervision and enforcement action by ASIC.

Margin loan borrowers will accordingly benefit from these measures once the new regime comes into force. The decision to include margin loans in Chapter 7 is mainly justified by the fact that it provides key protections to borrowers such as access to free dispute resolution arrangements, disclosure of important information and assurance that margin loan providers and other service providers are appropriately resourced and competent.

In addition, Chapter 7 includes a complete regulatory regime in relation to the provision of financial advice. This is important in the context of margin loans, as a considerable percentage of margin loans are taken out based on recommendations by financial planners. Planners providing such recommendations will be subject to requirements that the advice must be appropriate and based on reasonable inquiries, and must be set out in a Statement of Advice provided to the client.

Finally, inclusion in Chapter 7 is considered to impose the least regulatory burden on industry with respect to licensing requirements. Most margin lenders and financial planners are already in possession of an Australian Financial Services Licence (AFSL) issued under requirements specified in Chapter 7. Obtaining authorisation to issue or advise on margin loans will require a variation to an AFSL. This is a simpler process than requiring lenders and advisers to obtain a separate credit licence, which would be required if margin loans were regulated under separate legislation. For instance, if margin loans had been included in the new national consumer credit regulatory regime, lenders and advisers would be required to obtain an Australian Credit Licence under a separate and different set of licensing requirements as set out in the National Consumer Credit Protection Bill 2009.

Why responsible lending and notification requirements are prescribed.

Chapter 7 does not fully cover all aspects of margin loans as the regulatory regime was not originally designed for credit products. Accordingly, a number of adjustments are necessary to ensure the regime fits the characteristics of margin loans in providing an appropriate level of investor protection.

As set out above, the general credit legislation includes responsible lending obligations for lenders. The main purpose is to require lenders before providing credit to make an assessment whether the product is unsuitable for the consumer. If the assessment concludes that it is, then the loan may not be provided. This obligation ensures that a reasonable effort is made to prevent consumers from being given loans that they cannot afford.

While the majority of margin loans are not causing any problems for borrowers, there is evidence that in some cases borrowers have been given margin loans with features and risks that they did not fully understand. The recent collapse of Storm Financial, in particular, has left some clients who had entered into margin loan arrangements at risk of losing their homes due to double gearing strategies. Double gearing arises where clients borrow funds against the equity in their homes and use them as their equity contribution to a margin loan.

Through an unfortunate combination of circumstances some of these borrowers have fallen into negative equity in relation to the value of their security vis-à-vis their margin loan and are now having to repay outstanding amounts on the margin loan as well as continuing to service the loan secured against their home. Where borrowers do not have additional sources of funds to do so, they are at risk of losing their homes.

Indications are that not all of these borrowers were familiar with the way in which a margin loan operates, including the potential consequences of margin calls. In addition, they may also not have been fully aware that they exposed themselves to the risk of losing their homes when they borrowed against their home to fund the margin loan.

The Bill therefore includes provisions requiring margin lenders to make an unsuitability assessment before a margin loan is provided or the limit of an existing loan is increased, and not to provide the loan or the limit increase if the assessment concludes that the loan is unsuitable. A definition of unsuitability is provided as guidance to lenders, and says that a loan will be unsuitable where a borrower cannot service the debt or could only do so with substantial hardship.

Further guidance will be provided in the regulations as to what factors lenders need to consider in conducting these assessments. These will include factors that are specific to margin loans, such as whether a potential borrower has engaged in double gearing, as well as other, more general factors such as the total amount of debt taken out by the borrower.

A further provision regulates the notification of margin calls to clients, especially where the loan has been arranged through a financial planner. There have been situations where it has been unclear whether it was the lender or the planner who was responsible for notifying clients when a margin call occurred. Failure to notify a client in time can result in losses for the client. The amendments require that lenders must notify clients when a margin call is made, unless clients explicitly agree to notifications being provided through their planner.

In addition to the measures outlined above, a new margin loan disclosure document is being designed. This document will inform potential borrowers in concise and clear language of the key factors they need to consider before they take out a margin loan. It is currently being designed in close cooperation with margin lenders and other stakeholders and will be separately introduced through regulations at a later date.

Regulation under Chapter 7 of the Corporations Act, together with the additional requirements set out above, will provide consumers with a comprehensive set of protective measures when they take out a margin loan. This will constitute a major improvement in contrast to the current situation, where margin loans are only subject to patchy and inconsistent regulation.

Why the margin loan requirements are restricted to natural persons

The margin loan regulatory regime only applies to margin loans taken out by natural persons, including persons acting as trustees of a trust. This means that margin loans taken out by companies, including small businesses and family companies, will not be subject to this legislation.

There are a number of reasons for this approach. One major factor is that this approach is supported by industry. During consultation it was pointed out that, without such a restriction, the proposed legislation would have two potentially inappropriate effects:

- It would capture lenders that restrict their activities to large corporate borrowers. While some of the requirements, such as the provision of most disclosure documents, in Chapter 7 of the Corporations Act would not apply to such borrowers as wholesale clients, these lenders would still need to obtain an AFSL and comply with a range of other requirements in Chapter 7. A number of submissions queried whether it was an appropriate outcome to protect large corporate borrowers under legislation that was designed to protect retail investors; and

- The nature of bank lending facilities such as working capital loans, especially to small businesses, would make it inevitable that they would be captured by any comprehensive definition of a margin loan. Submissions argued that it would be an inappropriate outcome for business lending to be regulated under Chapter 7 of the Corporations Act which, as stated, was mainly designed to protect retail investors.

Secondly, the Government's decision on assuming responsibility for the regulation of credit includes a two phase plan, according to which business lending will be considered in Phase Two. Regulating business loans under the proposed margin loan legislation would have breached this commitment.

In view of these facts and arguments, the Government decided that the best approach was to restrict the scope of the current legislation to loans taken out by natural persons. Margin loans taken out by corporate entities, including small businesses and family companies, will be considered as part of Phase Two of the credit legislation, when the regulation of business lending as a whole will be considered.

TRUSTEE COMPANIES

In relation to trustee companies, the main objectives of the reforms are to:

- create a single national market for traditional trustee company services;
- provide a single national regime of licensing, conduct and disclosure;
- provide simple, low-cost alternative dispute mechanisms and compensation arrangements; and
- regulate the fees, commissions and other charges imposed by trustee companies.

EXISTING REGULATION

Trustee companies are currently licensed under State and Territory (State) trustee company acts to provide personal trustee services similar to those of a natural person. There are separate licensing requirements and supervisory arrangements in place in each of the jurisdictions. Once licensed, trustee corporations are required to submit regular financial returns to the respective jurisdictions, but are not subject to significant ongoing supervision.

For trustee companies that want to operate across State borders, these separate regimes act as a barrier to entry and impose additional costs. The authorisation decision-making processes are not transparent, and some trustee companies have reported being refused authorisation by a State without reasons being given.

In addition to being subject to the respective State trustee company acts, trustee corporations are subject to other State legislation, and rules of common law and equity, when undertaking 'traditional activities'. The legislation preserves the operation of these State Acts and the jurisdiction of the State Courts (for example, in relation to breaches of trust and the removal of a trustee). Also, all private trustee companies are registered corporations under the Corporations Act and are therefore subject to the same rules as other companies.

Consumer protection and disclosure

The consumer protection framework for trustee company services is patchy. If dissatisfied with a trustee company, the person who purchased the service (such as a future testator of a deceased estate, or the settlor or appointer of a trust) may change trustee companies. Once the original client has passed away, beneficiaries (for example of deceased estates or long term trusts) may have limited options if they want to challenge alleged underperformance or misfeasance by trustee companies.

The trustee company concerned may offer internal dispute resolution procedures, but it is not obliged to do so. Alternatively, beneficiaries can complain to the appropriate State Government Minister/Department responsible for administering trustee companies. Finally, they can approach the relevant State Supreme Court. Obviously, approaching the Supreme Court is a time-consuming and costly process, and one which may be beyond the resources of many beneficiaries.

A balance needs to be struck in this area between providing avenues for legitimate complaints and restricting complaints which may be ill-founded. The nature of a trustee company's work means that it is frequently called upon to exercise its discretion in a way that disappoints one or more beneficiaries. However, the trustee company may have acted in good faith and professionally.

The disclosure framework is also patchy. Without effective disclosure, clients and beneficiaries cannot monitor the performance of trustee companies or exercise their rights. While there are State laws requiring the provision of accounts in relation to deceased estates, the position is less clear in relation to charitable trusts and trusts set up by one living person to benefit another living person (*inter vivos* trusts).

Definition of 'traditional activities'

In general, a trustee company undertakes a traditional activity when it:

- prepares a will, a trust instrument, a power of attorney or an agency arrangement;
- applies for probate, and/or acts as an executor or as administrator, of a deceased estate;
- acts as trustee of a trust estate;
- operates a common fund;
- acts as attorney under a power of attorney;
- acts as a financial manager or guardian for another person, including where the other person is a minor, a disabled person or otherwise incapable of managing his or her own affairs.

Where trustee corporations engage in activities other than 'traditional activities', such as acting as a superannuation trustee, acting as a Responsible Entity for managed funds, or acting as a trustee for debenture holders, they are subject to Commonwealth legislation, including the *Superannuation Industry (Supervision) Act 1993* and the Corporations Act. All of the current private trustee companies hold Australian financial services licences – accordingly, they are familiar with financial services licensing and regulation administered by the Australian Securities and Investments Commission (ASIC).

History of harmonisation of trustee company regulation

There have been many attempts to harmonise the regulation of trustee companies over the last 15 years.

In August 1994, the Standing Committee of Attorneys-General (SCAG) issued a Discussion Paper on uniform trustee company legislation. The favoured model was prudential regulation.

In March 1997, the Financial System Inquiry (Wallis Inquiry) recommended uniform regulation of trustee companies. However, the Commonwealth and the States and Territories (the States) subsequently agreed that the Commonwealth would not assume responsibility for trustee companies when it assumed responsibility for regulating financial institutions.

In 2001, SCAG issued a Model Trustee Corporations Bill, which was intended to form the basis of a uniform scheme by being enacted in each of the States. A discussion paper was released with the Bill. The Bill was not proceeded with.

Green Paper on Financial Services and Credit Reform (June 2008)

In the Green Paper, the Government canvassed two options for national regulation of trustee companies:

Option 1. Consumer protection and disclosure (administered by ASIC)

Option 2. Prudential regulation (administered by APRA)

While both models offered a national licensing regime, the Government indicated that it preferred Option 1. Prudential regulation is generally aimed at protecting the prudential health of systemically important financial institutions, primarily for the maintenance of system stability. Trustee companies do manage significant amounts of money, but they are not systemically important in the way that (for example) banks, building societies, credit unions and many superannuation funds are.

Also, prudential regulation is generally more intrusive and expensive than consumer protection regulation. It would also raise significant competitive neutrality issues, because the main competitors of private trustee companies, such as public trustees, lawyers and accountants, are not subject to prudential regulation.

The Green Paper also noted concerns about the need for a more cost effective and timely alternative dispute resolution mechanism for beneficiaries to enhance the protections available for personal trust assets.

Nineteen submissions were received that commented on the proposal for Commonwealth regulation of trustee corporations. Fifteen submissions were supportive of Option 1 and two of Option 2. Consumer protection supervision was broadly considered the best option to meet the policy objectives of Commonwealth regulation. Prudential supervision was seen as unwarranted, given the higher compliance costs and the low level of systemic risk associated with the traditional activities of trustee corporations.

COAG'S DECISIONS

In July 2008, COAG agreed to the Commonwealth assuming responsibility for regulating the 'traditional activities' of trustee companies. In October 2008, COAG agreed that the Commonwealth would introduce relevant legislation in the first half of 2009. The States and Territories agreed to make necessary repeals and consequential amendments of their own laws by the end of 2009.

THE GOVERNMENT'S DRAFT LEGISLATION

On 7 May 2009, the Government announced the release of the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009 (Minister for Superannuation and Corporate Law Media Release No. 053 of 2009). Schedule 2 of the Bill deals with trustee companies. An Exposure Draft of the Bill was publicly released on the Treasury website, and comments were sought by 22 May 2009.

Fourteen submissions were received (including from the trustee company industry) commenting on the trustee company provisions. While most submissions were supportive of entity level regulation, some submissions raised concerns about aspects of the provisions. The industry's submissions raised a significant number of technical issues. Many of these technical issues were addressed in the revised version of the Bill.

Under the *Corporations Agreement 2002* (Corporations Agreement), the approval of at least 3 State and Territory Ministers (of whom at least 2 must be State Ministers) was required before the trustee companies provisions could be introduced into Parliament. To this end, the Minister for Financial Services, Superannuation and Corporate Law, the Hon Chris Bowen MP (Minister Bowen) wrote to State and Territory Ministers on 17 June 2009. The requisite number of State and Territory Ministers gave their approval for the legislation to be introduced.

As Minister Bowen stated in his Second Reading Speech, delivered on 25 June 2009:

> "The amendments in the bill in relation to the regulation of trustee corporations were the subject of consultations with state and territory representatives. This consultation included consideration of the draft amendments by the Ministerial Council for Corporations."
>
> "During that process, some state and territory ministers raised some issues which the Commonwealth will consider further. However, the council has approved the amendments for introduction, as required under the Corporations Agreement."

THE TRUSTEE CORPORATIONS ASSOCIATION OF AUSTRALIA (TCA)'S COMMENTS

Treasury has the following comments on the TCA's submission to the Senate Economics Committee (TCA comments are italicised):

Whereas the Exposure Draft envisaged that the States and Territories would each repeal their Trustee Companies Act, the Bill provides for the Commonwealth to assume exclusive responsibility for 'entity level' regulation of traditional trustee company services, with existing State and Territory legislation, and the rules of common law and equity, continuing to govern the functions and powers of trustee companies.

This approach was taken following consultations with the States, and on legal advice.

It is unclear how that amended model would work in practice - for example, how the obligations imposed on trustee companies by the Commonwealth legislation interact with the responsibilities of State and Territory tribunals in respect of 'represented persons'.

The Government is considering the application of the legislation to matters concerning 'represented persons'.

It would be unfortunate, and contrary to the underlying purpose of the move to Commonwealth regulation of the industry, if the new arrangements failed to deliver a more efficient system and reduced compliance costs.

Provided the States repeal their superseded and inconsistent provisions, the new arrangements should lead to greater efficiency and lower compliance costs.

We have reservations about all traditional trustee company services being designated as financial services under Chapter 7 of the Corporations Act, and requiring an Australian Financial Services Licence – that approach could have unwarranted implications in terms of the disclosure, conduct, advice and dispute resolution obligations that would be imposed on trustee companies.

The Government considers that applying the Chapter 7 regime to trustee companies is appropriate. As explained above, the Government considers that the main concerns in this area relate to consumer protection and disclosure. No other coherent models for regulating the industry have emerged.

Until the regulations are released, which will clarify the persons to be regarded as 'clients' of trustee companies, it is difficult to assess the likely appropriateness and cost of the AFSL obligations.

The regulations are expected to be released shortly.

The proposed mechanism for licensing trustee companies seems cumbersome; moreover, it is unclear if it will meet what we understood to be a key policy objective, i.e.: prohibiting a company that is not a licensed trustee company from providing the core distinguishing services of applying for probate and acting as executor / administrator of a deceased estate in a corporate capacity.

The mechanism of listing, and then licensing, companies is necessary, as there is no agreed definition of a trustee company. The listing mechanism will also enable the Commonwealth to ensure that public trust offices and other entities that offer traditional trustee company services (e.g. incorporated law firms) are not unintentionally regulated.

If a company is providing trustee company services without an AFSL covering the provision of the services, the Government will list it and, if the company remains non-compliant, then ASIC will take enforcement action.

The definition of 'person with a proper interest' in relation to an estate is unreasonably wide, as is the nature and frequency of the information that must be supplied to them, on request, by the trustee company.

It is considered this definition, based on the South Australian legislation (where it apparently works well), provides protection to an appropriately broad group of persons.

The fees applicable to traditional trustee company services should be fully deregulated for all clients, on the basis that strong competition from other trustee companies, public trustees and other market participants such as lawyers, and full disclosure of fees, provide an effective check on charges.

The Government has decided that fees charged to charitable trust clients should remain capped, both to protect those clients and to protect the revenue foregone by the Commonwealth.

We are very concerned with the proposal, which would seem to be without parallel in any other industry or profession, that where a court determines a trustee company's fees to be 'excessive' and should be reduced by more than 10 per cent, the company must pay the costs of the review.

Such a provision would require considerable subjective assessments by the court, which might not adequately take into account the quality, complexity and attendant risk of the trustee company's work compared with unregulated providers of estate management services, and could be used by disgruntled beneficiaries as an unfair bargaining tool to encourage a trustee company to settle.

If such a penalty provision is to be introduced, a threshold of 'by more than 25 per cent' would be more reasonable – also, it would be equitable for the other party to bear the cost of the review where the court finds that the fees were not excessive.

This provision reinforces the fee regulation provisions of the Act. It is intended to ensure that trustee companies charge appropriately and do not 'overservice' or spend excessive time on providing services.

The transitional arrangements should facilitate the rolling of present multiple licences held within the one trustee company group into one new licence, and the rolling of multiple Common Funds into one Common Fund by excluding any potential CGT on those transactions.

The regulations provide a provision for a Court to order the transfer of an estate from one trustee company to another. In relation to common funds, assuming none of the existing CGT exemptions apply, any application for a CGT exemption is carefully considered by the Government and the industry would need to put a well argued case for legislative change.

REGULATIONS

Regulations are being drafted by the Office of Legislative Drafting and Publishing.

QUESTIONS REGARDING THE LEGISLATION AND REGULATIONS

What is the constitutional basis for the amendments?

The Commonwealth has received advice that it does not need a referral of power from the State and Territory Governments to implement the regulation of trustee companies. Accordingly, the amendments are based on existing Commonwealth powers, in particular section 51(xx) of the Constitution (the corporations power).

Why are the provisions located in a new Chapter of the Corporations Act rather than in a separate Act?

There are a number of benefits in creating a separate chapter in the Corporations Act setting out the basic elements of a trustee corporation, while applying the provisions of Chapter 7 of the Act that are relevant to such corporations and integrating the provision of trustee corporations' "traditional" activities (estate administration and personal trustee management services) into the financial services regime.

Firstly, there is a precedent for such an approach in the form of Chapter 5C of the Act (managed investment schemes or MIS).

Secondly, this approach involves less duplication than the alternative. While a stand alone Act and a separate licensing mechanism would mean that all the requirements and obligations applying to trustee corporations would be consolidated in the one place, this would have the disadvantage that the obligations applying to trustee corporations would need to be duplicated or incorporated by reference in the new chapter. Also, rather than creating a separate licence for trustee corporations, an additional authorisation could be attached to the Australian financial services licence (which all Australian trustee corporations already hold).

Why are legal services provided by trustee companies deemed to be financial services?

It is necessary to deem legal services to be financial services to bring them within the ambit of Chapter 7 of the Corporations Act and to ensure these services can be regulated by ASIC under the AFSL regime. Also, while some services may be strictly legal, others involve handling money, and it is important to achieve comprehensive licensing and regulation, as far as possible, of trustee companies' traditional services.

Why have a number of important matters been dealt with in the Regulations?

It is not uncommon, in matters involving the Corporations Act, to deal with reasonably significant matters in regulations. In this case, dealing with matters in regulations allowed further consideration and discussion of these matters while still meeting the COAG timeframe for introduction of the legislation.

IMPACT ON PARTICULAR GROUPS

Trustee companies

The legislation will have advantages for trustee companies, particularly those that wish to operate in more than one jurisdiction. Trustee companies will no longer have to apply to be authorised in each State where they wish to operate, or to comply with the many different authorisation regimes in each State.

Trustee companies will have to comply with the Corporations Act, including new Chapter 5D (Trustee Companies) and Chapter 7. Trustee companies will also have to comply with the conditions of their AFSL. This includes any conditions imposed by ASIC under section 914A. While this creates some new compliance burdens, all private trustee companies are already Corporations Act companies, and all hold AFSL covering their non-traditional activities. Nonetheless, there will be some start-up and ongoing compliance costs.

Clients of trustee companies and beneficiaries of trusts/estates managed by trustee companies

The legislation will have a number of benefits for this class of persons. The Government expects that the development of a national market will lead to greater competition, which should improve quality and choice, and lower the cost of trustee company services.

This class of persons will have access, for the first time, to comprehensive disclosure and guaranteed low-cost dispute resolution processes. Compensation arrangements will also apply.

ASIC

ASIC envisages that it will need to train a small number of staff to deal with trustee companies. At present it is unsure whether there will be a significant number of complaints that it is has to deal with (i.e. that are not otherwise handled via EDR or the courts).

Further information about compliance costs and impacts is provided in the Regulatory Impact Statement.

DEBENTURES

The Bill amends the Corporations Act to create a consistent approach to the regulation of promissory notes, removing an anomaly in their regulatory regime dating back to the 1980s. Once implemented, promissory notes valued at $50,000 or over will come under the same regulatory regime as all debentures. The amendment addresses issues that arose in the case of Westpoint, which sought to avoid the operation of the law relating to debentures by issuing promissory notes with face values of at least $50,000.

Promissory notes, a form of debenture and debt instrument, are used by the issuer to raise funds from retail investors. In return, retail investors receive interest on their investment.

However, the current regulation of a promissory note differs depending on its value: promissory notes valued at less than $50,000 are generally regulated as debentures; at $50,000 or over, generally as financial products. This difference derives from distinctions between retail and wholesale investors incorporated in early 1980s legislation which is now considered to be anachronistic.

The proposed amendment is intended to harmonise the regulation of promissory notes and debentures by removing the dollar threshold which currently differentiates between the two products. Once in place, promissory notes issued to retail investors would be regulated under the same regime as debentures. Debenture issues must have in place a trust deed and appoint a trustee, who undertakes a range of investor protection functions on behalf of debenture holders.

The Bill also amends the Corporations Act to require ASIC to establish and maintain a register of debenture trustees, thereby providing potential investors with a source of information on trustees acting for a particular issue of debentures.

The establishment of the register enhances transparency by providing for public access to a list of trustees of debenture issues, providing consumers with information on who will be representing their interests in a debenture issue.

In June 2008 the Government released for consultation the Green Paper Financial Services and Credit Reform: Improving, Simplifying and Standardising Financial Services and Credit Regulation which canvassed a number of possible reforms in the financial services sector, including in relation to debentures regulation. Twenty submissions were received in relation to debentures. While four possible reforms were canvassed, after discussions with ASIC regarding its forthcoming review of debentures, it was decided to proceed initially with only the promissory notes amendment. This amendment was widely supported as it would clarify the operation of the legislation and provide consistency.

The trustees register reform was also included in the draft Bill, which was released as an exposure draft for three weeks from late May 2009. One submission was received, supporting both changes. ASIC, the financial services regulator, was consulted at all stages.

IMPACTS

Neither change will have a significant impact for business and/or issuers of debentures.

The harmonisation amendment will require issuers to issue a trust deed and appoint a trustee. This will create some further regulatory obligations, but the impact is estimated to be at a medium-low level, with benefits in terms of clarity and consistency within the regulatory regime. Additionally, debenture issuers will have to issue a prospectus instead of a product disclosure statement. As with any debenture issue, all issues will remain subject to the advice, dealing and licensing requirements of the Corporations Act.

The register of debenture trustees will extend the information already obtained under the Act by ASIC in relation to the appointed trustee of a debenture issue, although some additional information will now be collected for input into the publicly available register. The change has been identified to have a very low impact.