



INFORMATION, ANALYSIS
AND ADVICE FOR THE PARLIAMENT

INFORMATION AND RESEARCH SERVICES

Bills Digest
No. 39 2003–04

Financial Services Reform Amendment Bill 2003

ISSN 1328-8091

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Financial Services Reform Amendment Bill 2003

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7 October 2003

Contents

Purpose	1
Background	1
History of FSRA	1
Amendments to FSRA	2
Main Provisions	4
Unsolicited offers to purchase financial products, off market	4
Schedule 2 amendments	5
Definition of declared professional body	5
Definition of Basic Deposit Products	5
Definition of dealing	6
Licensing exemption for financial services provider regulated by overseas regulatory authorities	6
Obligation to notify ASIC of certain matters	7
Combining a Financial Services Guide and a Product Disclosure Statement into a single document	7
Situations where product disclosure statements are not required	8
Exemption and modification powers	8
ASIC exemption and modification powers	8
Exemption and modification powers using regulations	10
Other amendments	11
Concluding Comments	11
Endnotes	12

Financial Services Reform Amendment Bill 2003

Date Introduced: 26 June 2003

House: House of Representatives

Portfolio: Treasury

Commencement: The items in this Bill commence on a number of dates. Schedule 1 commences on the 28th day after the Act receives Royal Assent. All of schedule 2 (apart from item 88) commences on the day after the Act receives Royal Assent. Item 88 of schedule 2 commences on 1 July 2004. With the exception of item 1 of schedule 3, schedule 3 and schedule 4 commence on the day after the Act receives Royal Assent.

Purpose

This Bill makes a series of amendments to the *Corporations Act 2001* as amended by the *Financial Services Reform Act 2001* (FSRA). The amendments are designed to assist industry participants transition across to the new FSRA regime.

Background

History of FSRA

In 2001 the Corporations Act was amended by the FSRA to put in place revised regulatory arrangements for the financial services sector. The FSRA consolidated into one piece of legislation rules for consumer protection and market integrity in the financial services sector.¹ The regime, brought in by the FSRA, is contained in Chapter 7 of the Corporations Act.

Prior to FSRA, the regulations governing conduct in the financial services industry were scattered across a number of Acts and were based upon the institutional form of the service provider. For example, the *Corporations Act 2001* set out the regulatory arrangements for securities and futures contracts and securities and futures markets. The regulatory arrangements for deposit products were contained within the *Banking Act 1959*; for general and life insurance in the *Insurance Act 1973*, *Insurance (Agents and Brokers) Act 1984*, *Insurance Contracts Act 1984* and the *Life Insurance Act 1995*; and for

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superannuation in the *Retirement Savings Accounts Act 1997* and the *Superannuation Industry (Supervision) Act 1993*.

In 1997, the Financial System Inquiry² examined the regulatory arrangements. It found that there was a lack of consistent regulation for financial products and services that were similar in nature. It considered that inconsistent regulation caused confusion for consumers and limited their ability to compare different products. It also found that the inconsistent and outdated nature of the legislation restricted competition, innovation and the ability to make efficiency gains in the financial services sector. It recommended substantial changes be made to the regulatory environment.

In March 1997 the Treasurer announced the Corporate Law Economic Reform Program (CLERP). CLERP aimed to pick up the recommendations of the Financial System Inquiry. Following this announcement a series of consultation papers were released including the CLERP 6 consultation paper which examined financial markets and investment products.³

The policy proposals contained in the CLERP 6 paper were implemented through FSRA. FSRA repealed Chapter 7 (Securities) and Chapter 8 (The Futures Industry) of the Corporations Act. It consolidated the regulatory arrangements for securities and futures market and incorporated the consumer protection regulatory arrangements for other parts of the financial services sector (such as banking, insurance and superannuation) into the new Chapter 7 (Financial Services and Markets) of the Corporations Act. FSRA also made a number of consequential amendments to repeal the provisions in those parts of the Acts (mentioned above) that had put in place consumer protection and market integrity regulatory arrangements in the financial services sector.

In summary, FSRA has put in place the following:

- a single licensing, disclosure and conduct framework for all financial service providers
- a uniform disclosure regime for financial products, and
- a revised regulatory regime for financial markets (such as the Australian Stock Exchange and the Sydney Futures Exchange) and clearing and settlement facilities.

FSRA has been augmented by a vast number of regulations. ASIC has also released a number of policy statements to assist in interpreting and applying FSRA.

FSRA commenced operation on 11 March 2002 and is subject to a two year transition period ending on 10 March 2004.

Amendments to FSRA

It has been found that some parts of the FSRA have produced unintended and unworkable consequences. A number of regulations have been made since 11 March 2002 to remedy

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some of these deficiencies. The amendments to FSRA contained within this Bill are also designed to remedy some of the problems with the operation of FSRA. They are not intended to bring about any significant policy changes.

The Explanatory Memorandum to the Bill states that:

The Financial Services Reform Amendment Bill 2003 (FSR Amendment Bill) will clarify and amend various aspects of the regulatory framework governing the licensing, conduct and disclosure of providers of financial services, and the licensing of financial markets and clearing and settlement facilities, contained in Chapter 7 and related provisions in the *Corporations Act 2001* (Corporations Act). The FSR Amendment Bill will also make minor amendments to the *Income Tax Assessment Act 1997* and the *Retirement Savings Accounts Act 1997*.....

During the transition period, the Government has continued a consultation process with industry and consumer representatives that began during the development of the FSR Act, with a view to ensuring that the implementation of the new arrangements occurs as smoothly as possible.

As a result of this consultation process, a number of issues have been identified which require clarification or amendment to enable industry participants to transition to the new regulatory arrangements prior to the end of the transition period.⁴

Key provisions in the Bill, as introduced, cover the following issues:

- regulation of unsolicited offers to purchase financial products, off market
- definition of ‘basic deposit product’
- licensing exemptions for foreign financial services providers
- combining a Financial Services Guide and a Product Disclosure Statement into a single document, and
- ASIC exemption and modification powers.

In a letter to the Senate Economics Legislation Committee, dated 19 August 2003, the Parliamentary Secretary to the Treasurer, Senator the Hon Ian Campbell flagged a number of amendments proposed to be moved by the Government when the Bill is debated in Parliament. The letter from Senator Campbell sets out the detail of these further amendments.⁵

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Main Provisions

Unsolicited offers to purchase financial products, off market

Schedule 1 of the Bill regulates unsolicited offers to purchase financial products off market. It is a legislative response to the conduct of Mr David Tweed and his company, National Exchange Corporation Pty Ltd. Mr Tweed offered to purchase shares from small shareholders well below the market price of the shares. He did not disclose to shareholders that the offer price was below market price. As a result shareholders lost a large amount of money in agreeing to sell shares to Mr Tweed.

Mr Tweed relied upon the self dealing provisions in the Corporations Act⁶ to avoid having to hold an Australian Financial Services Licence and hence having to comply with the product disclosure obligations in the Act.

Regulations were made in April 2003 which provided that unsolicited offers in the nature of Mr Tweeds, needed to be accompanied by information regarding the market price of the product. However since that time Mr Tweed has continued to offer to purchase shares below market price without disclosing this fact due to loopholes in the regulations.⁷

Schedule 1 of the Bill puts in place arrangements to regulate off market bids such as those made by Mr Tweed. Key provisions are as follows:

- **Clause 1019E** which specifies the way in which off market offers are to be made (that is the offer must be personally addressed to the offeree).
- **Clause 1019F** which sets out the maximum period of time that an offer can stand (twelve months).
- **Clause 1019G** which specifies what must be included in an offer document (for example, that the offer document must contain the price for the financial product, the market value of the product and if it cannot be traded on a financial market, an estimate of the value of product as at the date of the offer).
- **Clause 1019H** which states that if the requirements in **1019E**, **1019F** or **1019G** are not complied with or the offer document is misleading or deceptive, the offeree can refuse to transfer the financial product to the offeror or if the transfer has already taken place, seek to have the financial product returned to the offeree.

Enforcement provisions are contained within **items 8 -26**. In particular, **item 8** specifies that ASIC may use its stop order powers⁸ where the offer document either fails to contain the information required by **clause 1019G** or is misleading or deceptive. In addition, criminal penalties will apply for failure to comply with the requirements in 1019E -1019G (**item 12**) and civil penalties will apply for failure to provide relevant information as required by section 1019G (**item 13**). A person may take civil action to recover loss or

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damage incurred if they were not sent an offer document that complied with proposed clause 1019E (**item 15**).

In his letter to the Senate Economics Legislation Committee, (referred to above) Senator Campbell flagged that the Government proposes to make two amendments to the off market bid provisions in the Bill, to strengthen its operation.⁹

Schedule 2 amendments

Schedule 2 makes other amendments to the Corporations Act.

Definition of declared professional body

When introduced into the House of Representatives in 2001, the Financial Services Reform Bill contained provisions in Part 7.6, Division 7 that exempted certain groups (known as declared professional bodies) from the financial licensing requirements. The Senate rejected this proposal and Division 7 of Part 7.6 was removed from the Bill. Many references to declared professional body still remain in the Corporations Act, and this Bill in **items 1, 8, 29-31, 41, 43,44, 52, 53, 57-60, 75, 76, 99, 100, 103, 110,111** removes these references.

Definition of Basic Deposit Products

Financial service providers and their authorised representatives are under a number of disclosure and training obligations under the Corporations Act. In particular the financial services providers and their authorised representatives must give their retail clients¹⁰ a Financial Services Guide (FSG)¹¹ and a Statement of Advice (SOA).¹² In addition, where personal financial advice is provided to a client, the provider of the financial advice must give the client a Product Disclosure Statement (PDS).¹³ The person providing the financial service must have received appropriate training so that they are qualified to provide the service.¹⁴

The Corporations Act sets out circumstances where financial service providers are exempt from the requirements to provide an FSG, SOA or PDS and have to meet lower training requirements. In particular the Act, as amended by the FSRA states that where the financial service relates to 'basic deposit products' the financial service provider is not required to provide an FSG, SOA or a PDS. In addition, the level of training for basic deposit products is lower than for other financial products.

The definition for a 'basic deposit product' is contained within section 761A of the Corporations Act. Part of the definition states that a financial product will qualify as a basic deposit product where the product has a fixed term of two years or less and is 'at call'. As a result of this limitation, deposit products that are, for example, held for five years or which are not 'at call', do not receive the exemption and financial service

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providers are required to meet the disclosure and training obligations. Providers of these products argue that this distinction is an anomaly and imposes unnecessary costs on their business. The Bill in **item 6 and item 7** amends the definition of ‘basic deposit product’ so that it applies to a product that has a maximum withdrawal period of 5 years and is not ‘at call’.

Definition of dealing

Section 766A of the Corporations Act defines when a person provides a financial service. A person provides a financial service if they ‘deal’ in a financial product. ‘Dealing’ is defined in section 766C of the Act and the regulations may prescribe conduct that is not taken to be ‘dealing’. **Items 14 and 15** amend the legislation so that regulations can prescribe circumstances that are taken to be ‘dealing’. It is proposed, for example, that the regulations will deal with financial products that are subject to a mortgage.¹⁵

Licensing exemption for financial services provider regulated by overseas regulatory authorities

Under the existing Part 7.6 of the Corporations Act, ASIC can exempt a provider of financial services from the Australian Financial Service Licensing requirements if the following conditions are met:

- the provider is regulated by an overseas regulatory authority
- the regulatory authority is approved by ASIC
- the service is provided in the course of carrying on the business that is the subject of the overseas authorities regulation, and
- the service is provided to wholesale clients.¹⁶

Essentially this provision ensures that foreign based financial service providers (providing services to wholesale clients)¹⁷ may obtain relief from the licensing requirements in the Corporations Act, if the foreign regulator has been approved by ASIC. This provision as currently drafted is problematic for two reasons:

- assessment of an overseas regulator will be, on many occasions, a lengthy and convoluted process, due to the scope of many foreign regulators’ powers, and
- ASIC’s approval relates only to the regulator and not to the conduct of particular individuals. This would appear to leave a gap in ASIC’s power to regulate activities in the financial services sectors in Australia.

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The Bill in **item 25** amends the existing provision and substitutes ASIC approval of the foreign regulator with a requirement that ASIC approve the particular financial service offered by the individual. The Bill states that ASIC will be required to publish its approval in the Commonwealth Gazette.

Obligation to notify ASIC of certain matters

Sections 912A and 912B of the Corporations Act impose a number of obligations on persons who hold a financial services licence. Section 912D of the Act states that a financial services licensee must report to ASIC as soon as it becomes aware that it has breached its licence obligations. Strictly followed, this requirement is unnecessarily onerous on financial services licensees. The Bill amends the Act so that:

- licensees will only have to report ‘significant breaches’ of their financial service licensee obligations (under section 912A and 912B) (**item 35**)
- licensees will only need to report ‘significant breaches’ of ‘financial services laws’. ‘Financial services laws’ are defined as relevant provisions in the *Corporations Act 2001*, the *Australian Securities and Investment Commission Act 2001* and other laws as specified in the regulations (**item 35**)
 - it has been suggested that the regulations will specify legislation under which APRA is given powers or functions,¹⁸
- the reporting period for these breaches is to be increased from three to five days (**item 35**).

Combining a Financial Services Guide and a Product Disclosure Statement into a single document

The Bill also amends the Corporations Act so that a Financial Services Guide (FSG) and a Product Disclosure Statement (PDS) may be combined into one document. As discussed above, a provider of a financial service and their authorised representatives are under an obligation to provide retail clients with an FSG, Statement of Advice (SOA) and a PDS. The Bill provides that a Financial Services Guide (FSG) and a Product Disclosure Statement (PDS) may be combined into a single document in circumstances set out in the regulations (**clause 942DA**). Essentially this amendment will mean that the disclosure process can be streamlined in appropriate circumstances. The Bill also states that a SOA must not be combined with either a FSG or a PDS (**clause 947E**).

At the time of writing, the regulations setting out the circumstances where the two documents may be combined were not publicly available.

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Situations where product disclosure statements are not required

The Bill also clarifies the situations where a product disclosure statement is not required. **Item 70** states that a PDS will not be required where the financial product is an interest in a self-managed superannuation fund and the trustee of the fund believes on reasonable grounds that the client has the information available to them. Essentially this amendment will reduce the administrative burden on trustees of self-managed superannuation funds.

Exemption and modification powers

Various provisions in the Corporations Act put in place delegated rule-making arrangements by providing:

- ASIC with exemption and modification powers, and
- regulation making powers in the Corporations Act itself.

The Bill proposes to amend those provisions in Chapter 7 and Part 10.2 (which contains the transitional arrangements for Chapter 7) of the Corporations Act that deal with delegation of rule-making powers.

ASIC exemption and modification powers

ASIC has various powers to exempt or modify the Corporations Act in relation to conduct or people. ASIC's exemption and modification powers are scattered throughout the Corporations Act. The exemption and modification powers in Chapter 7 and Part 10.2 of the Act¹⁹ contain an express limitation which states that:

ASIC cannot declare that provisions of this part are modified so that they apply in relation to persons or financial products to which they would not otherwise apply.

Other Chapters in the Corporations Act that contain ASIC exemption and modification powers are not subject to the same limitation.²⁰

The Bill in **items 48, 49, 66, 67, 92, 93, 106-109** proposes to amend ASIC's exemption and modification powers in Chapter 7 and Part 10.2 to remove this limitation, thereby making these parts consistent with other provisions in the Corporations Act. The Bill (in **item 42**) also inserts a new section (926A) giving ASIC exemption and modification powers in relation to Part 7.6 of the Corporations Act (Licensing of Providers of Financial Services).

The expansion of ASIC's exemption and modification powers was considered by the Senate Economics Legislation Committee which stated that:

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The committee believes that any delegation of power from the Parliament should be subject to thorough consideration and scrutiny, and notes that the Senate Standing Committee for Scrutiny of Bills is awaiting advice from the Minister as to why such power should be not be exercised by regulation rather than by ASIC.²¹

In regard to the amendments to Part 7.6 proposed in **item 42** of the Bill, the minority report to the Senate Economics Legislation Committee stated that:

The Labor members share the Committee for the Scrutiny of Bills concern and recommend that consideration be given as to whether to remove the proposed power provided to ASIC under section 926A.²²

It appears that the Committee's main concern with the proposed amendments to ASIC exemption and modification powers is that they constitute an inappropriate delegation of legislative power.

The High Court held in *Victorian Stevedoring Co Pty Ltd and Meakes v Dignan*²³ (Victorian Stevedoring) that Parliament can, through legislation, validly delegate legislative power. By way of rationale, in *Victorian Stevedoring*, the High Court noted that Parliament retained ultimate control of an exercise of delegated legislative power through its ability to repeal the enabling statute.²⁴

Any delegation of legislative power will need to be constitutionally valid. The Bill appears to satisfy two key constitutional law considerations, namely that:

- Parliament does not abdicate its legislative power and hence retains the ability to control the delegation of power (through its ability to repeal the enabling provisions in the Corporations Act), and
- the scope of the power delegated falls within a head of Commonwealth constitutional power.²⁵

One of the primary advantages of delegated rule-making is that it offers flexibility and responsiveness.²⁶ In arguing for the proposed amendment, the Explanatory Memorandum to the Bill stated that:

The [exemption and modification] powers are invariably used to provide some form of concessional treatment, rather than to impose additional obligations.

The Explanatory Memorandum went on to state that:

ASIC uses its exemption and modification powers to provide administrative relief from the operation of various provisions of the legislation in circumstances where it judges that application of those provisions is not warranted, or that they should apply in a modified way. In most situations, the exemption and modification powers are exercised in response to requests for relief from parties who are experiencing

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difficulties complying with a particular provision of the legislation or where the application of the provisions is not appropriate in particular circumstances.

Depending on the circumstances, the strict operation of the legislation may produce unintended or unreasonable results. Moreover, exemptions and modifications will often be necessary to facilitate innovative products that were not contemplated at the time the legislation was drafted, while maintaining an appropriate degree of investor protection.

The limitation mentioned above which prevents ASIC from declaring that a provision is modified such that it applies in relation to a person and/or financial product to which it would not otherwise apply presents a substantial impediment to the effective use of the exemption and modification powers.²⁷

Concerns regarding the use of delegated rule-making are well documented and include the following considerations:

- that there is a loss of ready public scrutiny (ie through Parliament) of rule-making, and
- the difficult and fractured way in which those rules can be accessed once they have been made.²⁸

In relation to the amendments proposed in the Bill, it is important to note that where ASIC uses its exemption or modification powers, this must be notified in the Gazette. However use of these powers will not be subject to any form of parliamentary scrutiny (either through committee or tabling in parliament).

Treasury has argued that the changes to ASIC's exemption and modification powers that remove the limitation on these power brings them into line with ASIC's powers in other Chapters of the Corporations Act and therefore should be permitted.²⁹ Similarly Treasury argues that the inclusion of an exemption and modification power in Part 7.6 is consistent with ASIC's exemption and modification powers in other parts of the Corporations Act.³⁰

Exemption and modification powers using regulations

Regulation making powers are included in a number of Chapters in the Corporations Act. Sections 854B and 1020G state that regulations may be made to exempt or modify the application of Chapter 7. These sections include the following words:

regulations made for the purposes of this section may declare that provisions of this part are modified so that they apply (with or without further modifications) in relation to persons, bodies or situations to which they would not otherwise apply

The Bill (**items 18 and 95**) removes these words from both sections. This removes any uncertainty in regard to the use of the ASIC exemption and modification powers.

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The Explanatory Memorandum to the Bill states

Given that it is proposed to remove from ASIC's exemption and modification powers the current limitation which prevents ASIC declaring that a provision is modified so that it applies to a person and or financial product to which it would not otherwise apply, subsection 854B(2) and paragraph 1020G(2)(a) will serve no useful purpose. Therefore, they will be repealed.

If subsection 854B(2) and paragraph 1020G(2)(a) were not repealed, this might suggest that the ASIC exemption and modification powers still do not permit ASIC to declare that a provision is modified so that it applies to a person and/or financial product to which it would not otherwise apply (that is because they do not contain a similar positive statement to this effect like those in subsection 854B(2) and paragraph 1020G(2)(a).³¹

The Bill (**item 42**) also inserts a power to make regulations exempting or modifying the operation of Part 7.6 of the Act.

Other amendments

Schedule 3 contains minor amendments to the *Income Tax Assessment Act 1997* and the *Retirement Savings Accounts Act 1997*.

Schedule 4 sets out the transitional arrangements for the amendments in Schedule 2.

Concluding Comments

This Bill contains a number of amendments to the Corporations Act to enable industry to transition across to the new regulatory regime put in place by the FSRA. The amendments do not raise new policy considerations.

The Bill also amends ASIC's exemption and modification powers in Chapter 7 of the Corporations Act. These amendments raise issues regarding the appropriate delegation of parliament's rule-making powers and in particular achieving the balance between rule-making arrangements that are flexible and responsive and having rule making processes in place that can be scrutinised by the Parliament and the public.

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Endnotes

- 1 FSRA did not address any prudential regulatory issues.
- 2 Otherwise known as the Wallis Inquiry after its Chairman Stan Wallis.
- 3 *Corporation Law Economic Reform Program Proposals for Reform: Paper No 6*, AGPS, 1997 [<http://www.treasury.gov.au/contentitem.asp?pageId=&ContentID=286>], 17 September 2003.
- 4 *Explanatory Memorandum, Financial Services Reform Amendment Bill (2003)*, p.1.
- 5 Parliamentary Secretary to the Treasurer, Senator the Hon Ian Campbell, Correspondence to the Chair, Senate Economics Legislation Committee [http://www.aph.gov.au/senate/committee/economics_ctte/reform_bill_03/report/appendix_3.pdf].
- 6 Corporations Act, section 766C(3).
- 7 ‘Loophole allows buy-on-the-cheap trader to stay in business’, *The Age*, May 5 2003.
- 8 ASIC stop order powers are contained in section 1020E Corporations Act.
- 9 As a footnote to this discussion, on 10 September 2003, the Federal Court ruled that National Exchange had engaged in misleading and deceptive conduct when it offered to purchase shares from OneSteel shareholders for \$2 per share, without disclosing that the purchase price would be paid in fifteen annual instalments of 13 cents per share, commencing on 3 September 2004.
- 10 ‘Retail client’ is defined in section 761G Corporations Act.
- 11 Corporations Act, section 941.
- 12 Corporations Act, section 946A.
- 13 Corporations Act, section 1011A.
- 14 Corporations Act, section 912A.
- 15 The Treasury, Corporations Amendment Regulations Commentaries, p. 4 [<http://www.treasury.gov.au/documents/642/RTF/Reg%20Commentaries.rtf>] 17 September 2003.
- 16 Corporations Act, section 911A(2)(h).
- 17 ‘Wholesale client’ is defined in section 761G Corporations Act.
- 18 Australian Association of Permanent Building Societies, Submission to the Senate Economics Legislation Committee [http://www.aph.gov.au/senate/committee/economics_ctte/reform_bill_03/submissions/sub01.doc].
- 19 Corporations Act, section 951B, 992B, 1020F, 1075A, 1437, 1442.
- 20 see for example Corporations Act section 601QA and section 673.

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- 21 Senate Economics Legislation Committee, *Provisions of the Financial Services Reform Amendment Bill 2003*, August 2003, p. 14
[http://www.aph.gov.au/senate/committee/economics_ctte/reform_bill_03/report/report.pdf],
17 September 2003.
- 22 *ibid.*, p. 27.
- 23 (1931) 46 CLR 73.
- 24 Administrative Review Council, *Report to the Attorney General, Rule Making By Commonwealth Agencies*, Report No 35, AGPS, Canberra, 1992, p. 5.
- 25 *ibid.*, p. 5.
- 26 Stephen Bottomley, 'Where did the law go? The delegation of Australian corporate regulation', *Australian Journal of Corporate Law*, May 2003, p. 118.
- 27 *Explanatory Memorandum Financial Services Reform Amendment Bill (2003)*, p. 9–10.
- 28 Stephen Bottomley, *Op cit*, p. 118.
- 29 *Explanatory Memorandum Financial Services Reform Amendment Bill (2003)*, p. 12.
- 30 *ibid.*, p. 17.
- 31 *ibid.*, p. 12.

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