EXPLANATORY MEMORANDUM

Minute No. of 2012 - Minister for Financial Services, Superannuation and Corporate Law

Subject - *Corporations Act 2001*
Corporations Amendment Regulations 2012 (No.)

Section 1364 of the *Corporations Act 2001* (the Principal Act) provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed by regulations, or necessary or convenient to be prescribed by regulations, for the carrying out or giving effect to the Principal Act.

The purpose of these proposed Regulations is to bring limited recourse borrowing arrangements (including instalment warrants) by superannuation funds into the Government's financial consumer protection framework.

Superannuation funds are regulated under the *Superannuation Industry (Supervision) Act 1993* (SIS Act). Generally, superannuation funds are not permitted to borrow funds except in limited circumstances. Limited recourse borrowing arrangements, such as instalment warrants, are one of the exceptions permitted under the SIS Act, under section 67A and 67B. Such arrangements are generally used by self-managed superannuation funds.

Limited recourse borrowing arrangements may be entered into over shares, securities and real property. These borrowing arrangements involve an up front payment to the issuer with the balance being repaid in periodic instalments.

Superannuation funds may be receiving inappropriate advice when purchasing instalment warrants from unlicensed and unqualified dealers. When purchasing from unqualified sources, superannuation funds are without access to consumer protections, such as product disclosure, indemnity insurance or dispute resolution mechanisms.

These proposed Regulations would make limited recourse borrowing arrangements financial products under the Principal Act when entered into by regulated superannuation funds.

The proposed Regulations would extend the Principal Act's consumer protections to superannuation funds when purchasing instalment warrants. Under the Principal Act, those dealing in (providing advice on and issuing) financial products must have an Australian Financial Services Licence (AFSL). AFSL holders are legally required to provide consumer protections to their clients.

To avoid overlap or unintended avoidance the proposed Regulations will make it clear that borrowing arrangements are not credit facilities under the Principal Act when entered into by superannuation funds.

Accordingly, the proposed Regulations amend the *Corporations Regulations 2001* (the Principal Regulations) to provide that:

- limited recourse borrowing arrangements are financial products under the Principal Act when acquired by superannuation funds;

- limited recourse borrowing arrangements are not a credit facility under the Principal Act when acquired by superannuation funds; and

- an AFSL covering derivatives or securities is taken to also cover limited recourse borrowing arrangements.

To this end, paragraph 764(1)(m) of the Principal Act provides that the regulations can declare a product to be a 'financial product' for the purposes of that section. In addition, paragraph 765A(h)(i) provides that a 'credit facility' is defined under the regulations. Regulation 7.6.01AA(1) of the Principal Regulations modifies section 911A of the Principal Act to give the power to deem that coverage of a financial product by an existing Australian Financial Service Licence (AFSL) may extend to covering another financial product.

The proposed Regulations would deem that an AFSL covering derivatives also applies to limited recourse borrowing arrangements. This will reduce the burden on AFSL holders without reducing consumer protection. AFSL holders covering derivatives will not need to re-apply for a separate AFSL to issue or provide advice about instalment warrants.

The Government has consulted with the general public and with affected stakeholders. 17 submissions were received, including from the Self-Managed Super Funds Professionals' Association of Australia Ltd, the Mortgage & Finance Association of Australia, the Association of Superannuation Funds of Australia Limited, and the Australian Bankers' Association. The regulations were changed in response to industry feedback – for example, regarding the kind of authorisation required to issue, or provide advice on, a relevant arrangement.

Details on these proposed Regulations are set out in the Attachment.

The Principal Act specifies no conditions that need to be satisfied before the power to make the proposed Regulations may be exercised.

The proposed Regulations would be a legislative instrument for the purposes of the *Legislative Instruments Act 2003.*

The Regulations would commence three months after they are made.

This Minute recommends that the regulations be made in the form proposed.

Authority: Sections 764, 765 and 1364 of the *Corporations Act 2001*

Details of the Corporations Amendment Regulations *2012 (No.)*

Regulation 1 — Name of Regulations

This regulation would provide that the name of the Regulations is the *Corporations Amendment Regulations 2012 (No.).*

Regulation 2 — Commencement

This regulation would provide for the Regulations to commence three months after the day they are registered.

Regulation 3 — Amendment of *Corporations Regulations 2001*

This regulation would provide that Schedule 1 of the Regulations amends the *Corporations Regulations 2001* (the Principal Regulations).

Schedule 1

Item [1] – New regulation 7.1.04H

Item [1] would insert a new regulation 7.1.04H in the Principal Regulations. The item defines who is an "issuer" of a limited recourse borrowing arrangement, which under proposed regulation 7.1.04J is declared to be a financial product. It also defines when such a product is "issued".

A product issuer may be obliged to hold an Australian financial services licence (AFSL) and to meet the disclosure obligations of the Act, where a product is issued to a 'retail client'.

Because a limited recourse borrowing arrangement involves numerous parties, it is difficult to determine which party is the "issuer", or when the product is "issued" for the purposes of the Principal Act. Without knowing who the issuer of the product is, there is difficulty in determining which party, if any, is obliged to disclose information required under the corporations legislation.

Subregulation (2) would provide that:

- a limited recourse borrowing arrangement is "issued" when a person enters into a legal relationship that sets up the arrangement; and

- each party to the arrangement is an "issuer" of the product.

New regulation 7.1.04J

Subregulation (1) would declare that a limited recourse borrowing arrangement as defined in sections 67A and 67B of the *Superannuation Industry (Supervision) Act* 1993 (SIS Act) is a financial product. This is necessary as such an arrangement may not fall within the general definition of a financial product.

To avoid unintended consequences, subregulation (2) would provide that certain arrangements are not intended to be covered, namely:

- a custodial or depository service within the meaning of section 766E of the Principal Act;
- any other kind of custodial or depository arrangement; and
- an administrative service provided in relation to a custodial or depository service or arrangement.

Item [2] – New sub-regulation 7.1.06(2A)

Item [2] would insert a new sub-regulation 7.1.06(2A) in the Principal Regulations. This subregulation would prevent persons that merely provide credit as part of a limited recourse borrowing arrangement from being caught by the new requirements.

Sub-regulation 7.1.06(2A) would provide that a limited recourse borrowing under subsection 67(4A) of the SIS Act is not a "credit facility" under the Principal Act.

Item [3] – Regulation 7.1.06B

Item [3] would omit regulation 7.1.06B in the Principal Regulations.

Regulation 7.1.06B is redundant because it duplicates regulation 7.1.05 and this opportunity will be used to remove it. This is a technical correction which has no relation to the other proposed amendments.

I**tem [4] – New regulation 7.6.01AB**

Item [4] would insert a new regulation 7.6.01AB in the Principal Regulations.

Regulation 7.6.01AB would provide that an AFSL which covers the provision of a financial service in relation to a "security" (as defined in section 92 of the Principal Act) or a "derivative" (as defined in section 761D of the Principal Act) is taken to cover limited recourse borrowings under sections 67A and 67B of the SIS Act.