



# Financial Services Law

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## THE ESSENTIAL INGREDIENT: ADD A PINCH OF INTEGRITY TO THE MIX

Are executives and directors subject to a higher standard of personal behaviour than the balance of society?

This is the question posed by the Vice Dean of the Wharton School at the University of Pennsylvania at the recent Directors' Consortium attended by 70 CEOs, CFOs and non-executive directors of listed American companies.

He considers the answer is "yes" and cites a compelling example from US experience – that of Martha Stewart. The principles are equally applicable in Australia and provide a salutary lesson as we move into a period of more regulation.

Martha Stewart is something of a guru in all things home and style and was the founder of New York Stock Exchange listed company Martha Stewart Living Omnimedia (Omnimedia). The success of Omnimedia followed Stewart's personal success.

In December 2001, in a personal transaction unrelated to Omnimedia, Stewart sold 3,000 shares in a biotech firm, ImClone. The sale occurred one day before the public announcement that a new drug developed by ImClone had not been approved by the Food and Drug Administration, at that time the share price in ImClone tumbled. Stewart was a personal friend of the CEO of ImClone, Samuel Waksal, who was arrested for insider trading. Stewart repeatedly denied involvement in insider trading, but that notwithstanding, shares in Omnimedia were affected, the price falling initially 12% and then 21%.

To what extent the impact on Omnimedia was a reflection of investor reaction to Stewart's perceived lack of integrity is impossible to measure, but that there was some backlash is clear. Locally, it is difficult to assess whether the impact would be as strong. The wildcard is the role played by the media and the possible outcome of media attention that focuses on the personal integrity of an individual.

In Australia, we have experienced the recent media scrutiny over the personal integrity of Dr Peter Hollingworth and consequent speculation of its impact on the public perception of the role of

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Governor General. Arguably, the integrity of the incumbent influences the perceived value of the role.

### RISK MINIMISATION

The issue for public companies is clearly that when assessing the suitability of a candidate for a senior position, their personal integrity is in issue as well as their professional reputation.

*Lyn Nicholson, Partner*

## NEW ACCC CHAIRMAN PROMOTES 'CULTURE OF COMPLIANCE'

At a special briefing session on 9 September 2003, the new ACCC chairman Graeme Samuel fielded questions from journalist Alan Kohler before an audience of 500, the majority of whom were lawyers.

Samuel stressed that the ACCC relies on the work of its highly motivated staff and decisions made by the ACCC are made by the five Commissioners after considered review. This line of questioning drew an inevitable contrast between Samuel and the former chairman, Professor Allan Fels.

In response to questions of whether Samuel was going to be "soft" on the interests of big business, he indicated that he would not and that, while organisations with a culture of compliance had nothing to fear from the ACCC, those with no such systems that cost the community through systemic non-compliance did have something to fear.

### WHAT ARE THE IMPLICATIONS FOR FINANCIAL SERVICES ORGANISATIONS?

All the work that is currently being undertaken to keep up with the Financial Services Reform Act has the potential to deliver a double dividend if it engenders a compliance culture to protect financial services organisations from potential ACCC concerns.

*Lyn Nicholson, Partner*

## REVIEW OF THE INSURANCE CONTRACTS ACT 1984

The Minister for Revenue and Assistant Treasurer, Senator Helen Coonan, and Parliamentary Secretary to the Treasurer, Senator Ian Campbell,

announced a review of the *Insurance Contracts Act 1984* on 10 September 2003.

The review is aimed at ensuring the Act continues to meet its original consumer protection objectives and does not discourage insurers from writing policies in Australia. In her press release, Senator Coonan said particular concern has been expressed about the operation of section 54 of the Act; this is a controversial provision which limits the extent to which the insurer can deny (or modify) its liability under a claim as a result of the conduct of the insured.

Senator Coonan asserts that judicial interpretation of section 54 may present an obstacle to more insurers entering the Australian market for liability insurance, thereby adding to the cost and reducing the availability of cover. The review will be chaired by Mr Alan Cameron.

Given the particular concerns about section 54 of the Act, the panel has been asked to report to the government on this provision by no later than 31 October. The balance of the panel's report is due by 31 May 2004. Further information relating to the review will be available from the Review's website at <http://icareview.treasury.gov.au>

Insurers should consider the opportunity arising from this review to raise other concerns about the Insurance Contracts Act. In particular, life insurers could rightly complain about the unintended consequences of section 29 and seek appropriate amendments.

*Peter MacKenzie, Partner and Andrew Logan, Lawyer*

## THE SUPER GUARANTEE PAPER TRAIL

Most employers would be familiar with the term "ordinary time earnings" (OTE) which is the "earnings base" on which superannuation contributions are calculated (currently 9%) in order to satisfy their obligations under superannuation guarantee legislation. For superannuation funds established after 20 August 1991, an earnings base must be at least OTE, that is, the total of the employee's earnings for ordinary hours of work, over-award payments, shift loading and commission (up to the maximum contribution base for an employee).

In contrast, for superannuation funds established before 21 August 1991, an "earnings base" used before that date may continue to be used by an employer, regardless of whether it equals OTE, provided the earnings base has not been reduced. Establishing the applicability of the "transitional" provisions of the *Superannuation Guarantee Administration Act (SGAA)* is a question of fact, and an employer must establish a continuous "paper trail" of events from before 21 August 1991 to the present. This may include demonstrating continuity of relevant defined terms in trust instruments

or rules relating to award conditions or employer practices. This can be an onerous and involved process.

In response to the complexity of this area, the Senate Select Committee on Superannuation and Financial Services recommended in April 2001 that the provisions in the SGAA enabling employers to rely on a pre-21 August 1991 earnings base be removed. However, no changes of this nature have as yet emerged.

We also note the comments of Justice Wilcox in *Construction Forestry Mining & Energy Union v Queensland Coal and Oil Shale Mining Industry* [2003] FCA 787, that the provisions of the SGAA “would be unintelligible to most people. They are complex in the extreme” and recommended an overhaul of the legislation to simplify its provisions.

It remains to be seen whether much-desired changes to superannuation guarantee legislation will be realised, or whether the “transitional” arrangements will be removed. In any event, regardless of the basis on which an employer contributes superannuation for its employees, a crucial factor for employers wishing to successfully defend any challenge to the basis on which it makes superannuation contributions will be to have in place appropriate documentary records evidencing satisfaction of its superannuation guarantee obligations (extending over a period commencing from before 21 August 1991 where relevant).

**Scott Charaneka, Partner and  
Emily Nighjoy-Wong, Lawyer**

## WHEN IS A STEP-CHILD A STEP-CHILD?

Consider Jane, step-daughter of the recently deceased David. In the claimstaking process, Jane asserts she is entitled to 100% of David’s death benefit from X Superannuation Fund as a “dependant child” of the deceased. Following satisfaction of Jane’s identity as David’s step-daughter and other relevant matters, the trustee accepts this and pays the benefit to Jane.

In a scenario like the above, trustees should also consider the implications of the status of the claimant beneficiary as a step-child. The Queensland Full Court in *Re Burt* [1988] 1 Qd R 23 held that the relationship of step-child and step-parent ceased to subsist after the termination of the marriage which created it, by divorce or death. A number of courts of other States have also followed suit (see, for example, *Basterfield v Gay* (1994) 3 Tas R 293; *Re Will and Estate of Popple* Full

Court S/Ct Vic (20 March 1997) (unrep)). While this issue has not been tested in a higher court of New South Wales, trustees should be aware that the position of the Superannuation Complaints Tribunal is that, where a natural parent predeceases a step-parent, the “step-relationship” between step-child and step-parent is dissolved.

This means that the step-child would not automatically fall within the definition of a “child” for death benefit purposes, but would need to establish financial dependency on the deceased in order to be considered as a “dependant” under SIS. Accordingly, trustees should review their processes and disclosures to ensure that claims assessors consider this issue in the claims process.

**Scott Charaneka, Partner and  
Emily Nighjoy-Wong, Lawyer**

## MULTIPLE ISSUER PDS

Life insurers often seek to promote insurance through superannuation schemes. Typically, in the past, both membership of the superannuation scheme, and the insurance product, have been offered in the same information brochure. Under the FSR regime, membership of the superannuation scheme is regarded as a separate financial product offered by the trustee of that scheme. This raised the question as to whether the life insurer and the trustee could offer both “products” in a single product disclosure statement (PDS). A recent Investment and Financial Services Association (IFSA) Circular (dated 8 September) outlines ASIC’s current position in this regard.

ASIC has advised the IFSA of “in-principle” approval to class order relief in relation to the preparation and issue of multiple issuer PDS under Part 7.9 of the Corporations Act. The relief, however, only applies where:

- the issuers are related bodies corporate (as defined in section 50 of the Act);
- the financial products offered in the single PDS document are of the same type (by reference to the list of financial products set out in section 764A of the Act);
- the PDS fully discloses the relationship between the issuers; and
- the issuers are all subject to the PDS disclosure regime under Part 7.9 of the Act.

ASIC has also agreed “in-principle” to extend class order relief to allow switching and top ups across multiple financial products offered under a single PDS. Unfortunately, by corollary, it appears that it is ASIC’s view that a multiple issuer PDS does not comply with the PDS disclosure regime under Part 7.9 of the Act where separate issuers, whether related parties or otherwise, offer life insurance and superannuation products in the same PDS.

**Peter MacKenzie, Partner and  
Andrew Logan, Lawyer**

## NEWS IN BRIEF

### ASIC NEWS

#### **ASIC releases updated industry guides for AFSL applicants**

ASIC has released updated versions of its industry-specific guides, which are designed to help industry participants in the process of applying for an Australian financial services licence (AFSL). The updated guides contain amendments in light of regulatory changes, including new regulations and ASIC class orders, which have widened the categories of applicants able to apply for their AFSL under the streamlining process.

#### **Ethical disclosure**

ASIC has released draft guidelines for the inclusion of information relating to labour standards and environmental, social and ethical factors in the PDSs of investment products, as required under recent reforms to the Corporations Act. The non-prescriptive approach taken by ASIC allows product issuers to determine for themselves:

- whether or not they have regard to any aspect of these considerations;
- to which particular factors they have regard; and
- how they will consider the factors, in terms of methodology, weighing etc.

If a product issuer has no set approach to these factors, they must make this clear.

#### **Discretionary Powers – Wholesale Foreign Service Providers**

On 12 September 2003 ASIC released Policy Statement 176 relating to the entry of foreign providers of wholesale financial services, who are regulated by overseas regulatory authorities, into the Australian market. The policy statement allows, where the particular requirements are met, that a foreign financial services provider can provide services to wholesale clients in Australia without first obtaining an AFSL, if the overseas regulation of the provider is sufficiently equivalent to the Australian regime.

### SUPERANNUATION

#### **Audit report: APRA's supervision of super entities**

The Australian National Audit Office (ANAO) has tabled an audit report on APRA's supervision of approved trustees and super funds registered under the 1993 Act. Following are some of the report's conclusions:

- a risk-based supervisory approach has yet to be consistently and comprehensively applied in relation to APRA regulated funds;
- APRA's review of funds and trustees has been impacted by re-organisation, relocation and changes to case selection and auditing methodologies;
- improvements could be made to APRA's regulatory functions, including reporting of super funds' lodgment of annual returns, risk identification and review; and
- improvements could be made to APRA's operational processes, including timely documentation of APRA's supervisory reviews of super funds.

### GOVERNMENT RESPONSE TO HIH ROYAL COMMISSION RECOMMENDATIONS

On 12 September 2003 the government released a table of its recommendations in response to the HIH Royal Commission into the failure of the HIH Insurance Group including some 61 policy recommendations.

### CORPORATIONS AMENDMENT REGULATIONS 2003 (batch 5) RELEASED FOR COMMENT

Proposed amendments include:

- provision of a PDS to prospective superannuation fund members or trustee of an existing self-managed superannuation fund;
- removal of obligation for responsible person to provide a PDS to a prospective member of a self-managed super fund in certain circumstances;
- product providers such as superannuation funds may hold money on trust for the person who is entitled to the money, rather than the person who paid it; and
- enhancing the disclosure requirement in relation to the amount of a 'withdrawal benefit' or other significant benefits – this may include informing the super fund member that the withdrawal benefit is an indicative estimate that may vary from the actual benefit provided.

**Georgina Orr, Lawyer and Andrew Goldstein, Technical Analyst**

## IN PROFILE



#### **Sarah Sheffer, Technical Analyst**

Sarah joined the Financial Services Group in late August and her principal areas of practice are Corporate and Commercial, Financial Services, and Compliance. Sarah's experience includes working as a Licensing Analyst for ASIC, where she reviewed applications for Australian financial services licences (AFSL); implemented changes to corporations laws and regulations in the AFSL context; undertook surveillance of AFSL holders, making recommendations where appropriate; and also reviewed trust documentation for registration under Chapter 5C of Corporations Act 2001 (Scheme Constitutions and Compliance Plans).

This publication is not legal advice. Professional advice should be sought before applying the information to your particular circumstances.

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