



June–July 2004

# Financial Services Law Bulletin

## in this issue

---

ASX simplifies Responsible Executive regimes **2**

---

Ebsworth delivers on 'fit and proper' **3**

---

Update on fee disclosure **3**

---

News in brief **4**

---

## Not the final word on section 56

■ *Walton v The Colonial Mutual Life Assurance Society Ltd*  
[2004] NSWSC 616, 16 July 2004

This recent judgment of the New South Wales Supreme Court involved consideration of section 56 of the Insurance Contracts Act (ICA) in the context of an alleged fraudulent claim made under an income protection life insurance policy.

### The facts

The plaintiff, Mr Walton, had an income protection life insurance policy (similar to a sickness and accident policy) with Colonial Mutual Life Assurance Society ("Colonial"). Under the terms of the policy, Walton was entitled to \$8,500 per month if he was totally disabled as defined under the policy. He suffered a heart attack in November 2000, and claimed under the policy in December of that year. Colonial made payments under the policy from December 2000 until May 2003, when it purported to terminate the policy.

Colonial ceased payments on the basis that section 56 of the ICA entitles an insurer to refuse to pay claims which are fraudulently made. The alleged fraud concerned the fact that Walton had said he was not working in his claim forms when in fact he continued to work, albeit in a reduced capacity, during the period that he was receiving payments from Colonial.

Colonial also alleged that Walton deliberately or recklessly gave false answers in his claim forms, and that this fraudulent conduct constituted a breach of his duty of utmost good faith under section 13 of the ICA, enabling Colonial to cancel the policy.

### No fraudulent conduct

Justice Einstein found that Colonial had not discharged the onus of proving that Walton had a dishonest intent to induce a false belief in Colonial for the purpose of obtaining benefits under the policy. His Honour considered that while Walton's idea of "unable to work" may have been conceptually different from that of Colonial, it nonetheless did not demonstrate:

...an intent to defraud, an intent to make false statements of fact, or an intent to make statements knowing them to be false or not believing them to be true or to make such statements recklessly careless whether they were sure false. (at para 170)

### Avoidance, cancellation and section 56

Also of interest, was the preliminary question of whether section 56 allows an insurer to cancel a contract of insurance. Section 56 prohibits an insurer from avoiding a contract *ab initio* because of a fraudulent claim. The section is silent, however, as to whether the insurer can cancel the policy because of a fraudulent claim. Cancellation could operate prospectively; that is to say, the termination of the contract would be on the basis of material breach, such that any accrued rights and liabilities not impacted by the breach are not affected.

The right of cancellation under section 56 has not previously been the subject of judicial consideration. Justice Einstein held that section 56 does not allow an insurer to cancel a contract of insurance. He does not explain his decision; rather he concluded that to permit cancellation of the policy under section 56 would be to misconstrue that section and would be a misconception of the legislative objective behind section 56.

It seems to us however, that there are arguments to the contrary. Importantly, the Australian Law Reform Commission, in its Report which led to the drafting of the ICA, states the following:

...an insurer should be entitled to cancel the contract if the insured fails to comply with the duty of utmost good faith. It would be quite inconsistent with that duty if the insurer were required to remain liable in such cases... the insurer's right to cancel should extend to cases where the insured makes a fraudulent claim... **An insurer cannot be expected to continue to provide cover to an insured who has made a fraudulent claim...** (emphasis added)

It is not yet known whether the insurer will appeal this decision, but it seems to us, in any event, that this will not be the final word on section 56.

Georgina Orr Lawyer  
e: gorr@ebsworth.com.au

Peter MacKenzie Partner  
e: pmackenzie@ebsworth.com.au

## ASX simplifies Responsible Executive regimes

The Australian Stock Exchange (ASX) announced on 21 May 2004 key changes to its Responsible Executive regime on the basis that, as structured, that regime was not properly in line with its objectives.

From an experience and competence perspective, the ASX will in future rely on the Responsible Officer standards established by the Australian Securities & Investments Commission (ASIC), rather than maintain their own similar but different criteria. This change is to be implemented immediately.

In addition, the ASX has changed its position of requiring at least two Responsible Executives (which is consistent with ASIC's perspective). Rather, the ASX has determined this is a matter best left for the participant to determine. This change is also to take place immediately.

From a legal liability standpoint, the ASX has indicated that Responsible Executives, rather than being primarily accountable to the ASX, will be primarily accountable to the participant. Further, the ASX has recognised that primary compliance responsibility should fall with the participant rather than its officers or employees. In addition, the ASX's ability to directly fine Responsible Executives will be removed. These changes have been implemented in the second phase of reform, which commenced on 16 July 2004.

Participants (including Principal Traders who were formerly known as "RIOTs") should note that the former ASX Broker Exam has been replaced with a Responsible Executive Exam (which may be structured to cover either the ASX Market Rules only, the ACH and ASTC Rules only, or ASX and ACH Rules only), which all Responsible Executives had to sit by 16 July 2004 or face possible suspension.

In addition, transitioning to the new regime requires completion of documentation in the form of a Notification and Undertaking which can be obtained from the ASX.

Andrew Goldstein Technical Analyst  
e: agoldstein@ebsworth.com.au

## Ebsworth delivers on 'fit and proper'

Ebsworth & Ebsworth has lodged a submission with APRA in response to its March 2004 call for submissions on its proposed "fit and proper" standards for Responsible Persons of APRA regulated entities. This covers ADIs, life companies and general insurers.

In our submission we found that there is material scope for the Australian Prudential Regulation Authority (APRA) to have regard for existing standards of conduct and character ("core probity") and basic knowledge, experience and supervisory/management skills ("core skills") already implemented by other regulators. At the same time, we recognise and appreciate APRA's position that the demands of particular roles within different types of financial services institutions require different technical knowledge and expertise. We identified certain regulatory gaps in APRA's proposals and areas of overlap between the regulatory regime proposed by APRA, and those covered by ASIC (in ASIC Policy Statement 164 Licensing: Organisational Capacities), and the ASX Responsible Executive regime.

Interestingly, the ASX Responsible Executive regime has undergone further recent changes along the lines suggested in our submission. In ASX Guidance Note 11 (June 2004), the ASX clearly recognises that many institutions are already subject to the ASIC regime for Responsible Officers and, accordingly, the ASX now gives appropriate recognition to those existing standards.

More details on our submission are available on our website at [www.ebsworth.com.au](http://www.ebsworth.com.au)

Andrew Goldstein Technical Analyst  
e: [agoldstein@ebsworth.com.au](mailto:agoldstein@ebsworth.com.au)

## Update on fee disclosure

### Revised dollar disclosure regulations released

The revised regulations (known as "Batch 8") were made on 24 June 2004. Once gazetted they will provide for a six month transition period.

The revised regulations require licencees (and their representatives) and product issuers to disclose various

fees, benefits, costs and interests as amounts in dollars in SOAs, PDSs and periodic statements from 1 January 2005.

These matters need not be disclosed as amounts in dollars where ASIC makes a determination that, for a compelling reason, dollar disclosure is not possible, unreasonably burdensome or contrary to client interests.

ASIC plans to release a policy proposal paper shortly to discuss how it will enforce the regulations and how it proposes to use its power to make determinations regarding dollar disclosure.

### Soft dollar benefit disclosure in FSGs and SOAs

Early in June ASIC released its Report on the disclosure of "soft dollar" benefits, with suggestions for effective disclosure to comply with the law. Among other matters, ASIC's research has found that there is some way to go for adequate disclosure of "soft dollar" benefits across industry.

The Report is stated to focus on retail financial advisers and their licensees who provide personal advice on issues such as superannuation, managed funds and life insurance. While ASIC's research focuses on this sector, ASIC notes that the same principles apply to other regulated financial advisers, such as specialist insurance advisers.

Advisers are required to disclose any conflict of interest resulting from accepting "soft dollar" benefits. The Report provides guidance in respect of the level of detail recommended for such disclosure in FSGs and SOAs, by highlighting features of good disclosure to assist industry. In preparing disclosure documents, advisers may also wish to bear in mind the Corporations Amendment Regulations 2004 ("Batch 8") which govern when costs, fees and benefits need to be disclosed in dollar terms in a SOA and some other documents. Batch 8 has been assented to and has a proposed start date of 1 January 2005.

The Investment and Financial Services Association (IFSA) and the Financial Planning Association of Australia (FPA) have confirmed that an industry-wide code on "soft dollar" benefits is to be established by the end of the year. A draft version of the joint code was published in December 2003.

The Australian Investors Association (AIA) has also issued its own policy proposal paper on "soft dollar" benefits and disclosure, including recommended wording for disclosure of benefits. It remains to be seen to what extent the AIA's proposals are considered by industry to be appropriate for adoption.

### PDS fee disclosure

ASIC has also released a revised version of the good practice model for fee disclosure in Product Disclosure Statements (PDSs) of investment products. The revised version includes the following changes:

- disclosure of fees gross of tax;
- separate disclosure of administration and investment management costs;
- a single “see at a glance” table containing a reference to all fees and costs, both direct or indirect and stated in dollars or translated to dollar terms;
- simpler terminology to aid consumer comprehension;
- clarification of ASIC’s expectations for use of the model, including what should be included in the Important Additional Information section following the table.

### Government package for superannuation and MIS fee disclosure

The government has released a package of reforms aimed at improving and simplifying the disclosure of fees and charges by superannuation funds and managed investment schemes, including:

- mandating use of ASIC’s fee template in PDSs;
- mandating the extension of ASIC’s fee template to periodic statements;
- a new single-figure fee comparison table in PDSs; and
- a new boxed consumer advisory warning in PDSs.

The measures are expected to be introduced progressively between 1 January 2005 and 1 July 2005. Draft regulations will be released in due course for public comment.

Emily Nighjoy-Wong Lawyer  
e: enighjoywong@ebsworth.com.au

## News in brief

### Superannuation

- The government and Australian Democrats have finally reached agreement on the passage of the Choice of Superannuation Fund Bill 2002, which is proposed to take effect on 1 July 2005. Among other matters, agreement has been reached for the requirement for minimum life insurance cover.
- APRA has released guidance material on applications for trustee licensing and super fund registration pursuant to the new Super Safety legislation. Application forms are available on APRA’s website and will need to be printed and lodged as hard copy documents. For more information, contact Robert Severino – email: rseverino@ebsworth.com.au or phone: 02 9234 2530.
- ASIC has released a new superannuation calculator

that allows consumers to see the long-term effects of:

- the most common fees charged by various funds;
- making extra contributions;
- receiving government co-contributions;
- breaking or reducing contributions as a result of time out of the workforce; and
- switching investment strategy or changing funds.
- The proposed design features of the new market-linked income stream – which will be available from 20 September this year – has been released by the government. Related to this measure is the proposal for a transition period to allow members of DIY funds at 11 May 2004 the ability to commence a complying lifetime or life expectancy pension when they retire until at least 30 June 2005.
- Treasury has released revised draft regulations for splitting of superannuation. The regulations are proposed to apply from 1 July 2004, but will only be mandatory on super funds from 1 July 2005. The revised regulations provide that:
  - a roll over, transfer or allotment will be considered a “contribution splitting ETP” under s27A(1) of the *Income Tax Assessment Act 1936* and there will be an assumed election for the purposes of s27D(1);
  - the transfer of super benefits will be based on contributions made in the previous year, with a limit of 60% of a member’s previous year deductible contributions (there is no restriction or undeducted contributions);
  - amounts rolled over to a retirement savings account will be taken to be preserved benefits;
  - superannuation benefits cannot be transferred if a “payment split” or “payment flag” under the *Family Law Act 1975* is operating.
- The Superannuation Industry (Supervision) Amendment Regulations 2004 (No 2) (SR No 84 of 2004) has been referred to the Senate Economics Legislation Committee for report by 3 August 2004. The regulations address a range of tax avoidance strategies, primarily involving small superannuation funds, including defined benefit funds.
- The Tax Laws Amendment (2004 Measures No 2) Bill 2004, giving effect to measures relating to the taxation of overseas superannuation payments, has been passed by the Senate without amendment and is awaiting assent.
- APRA released Notice of Financial Sector (Correction of Data) Determination No. 7 of 2004 on 14 July 2004 to vary the superannuation reporting standards. The new standards apply to trustees of superannuation entities from 14 July 2004. Briefly, the new standards include:
  - confirmation that trustee may lodge quarterly and annual returns through an agent; and
  - removal of authorisation requirements for quarterly and annual returns.

### General insurance

The Insurance Council of Australia (ICA) has released a draft new General Insurance Code of Practice, which includes the following proposals:

- cutting down response times for private claims from 15 days to five;
- addressing insurers' response to natural disasters such as floods or bushfires; and
- allowing foreign or unlicensed operators, currently not held to account under the FSR Act, to adopt the 2004 Code, meaning that more policyholders will have access to dispute resolution processes.

The new code will supersede the 1994 model and will be expanded to take commercial insurance and public liability, as well as intermediaries such as insurance brokers, under the self-regulatory umbrella. The ICA invites comments on the new draft code from consumers, business and government until 8 September 2004.

The ICA has appointed David Knott, former chairman of ASIC, to independently review public submissions on the new draft code of practice.

### Managed funds

ASIC will grant relief from section 601GA of the *Corporations Act 2001* to enable industry to continue to register constitutions, including transaction costs allowance provisions, in the form accepted up to now, for the next six months.

### Update on CLERP 9

The CLERP 9 Bill passed both Houses of Parliament on 25 June 2004. Most of the provisions in the Act commenced on 1 July 2004, however, Schedule 3 of the Act, which provides for proportionate liability in respect of civil actions for loss or damage for misleading or deceptive conduct, inducement and dishonest conduct in respect of financial products, became effective on 26 July 2004.

On 1 July, ASIC released two policy statements and two practice notes to explain requirements under CLERP 9. These new policies are:

- PS 180 – Auditor registration
- Revised Practice Note 34 – Auditor's obligations: reporting to ASIC
- Revised Practice Note 66 – Transaction-specific disclosure; and
- Revised PS 173 – Disclosure for the on-sale of securities and other financial products.

ASIC stressed that these new policies may be reviewed once the final form of the CLERP 9 legislation and regulations are released. ASIC has also established an online registration system for auditors.

### More guidance on SOAs from ASIC

In its media release [MR04/236], ASIC clarifies its expectations in relation to the provision of clear, concise and effective Statements of Advice (SOAs) by setting out the following guidelines:

1. Advisers should adopt a flexible approach to their SOAs (e.g. short and simple advice should result in a short and simple SOA).
2. Extraneous information (i.e. information not required to be included under current law) should not be included if it results in the SOA not being clear, concise and effective. Where extraneous information is included, it should be clearly distinguishable from the mandatory information.
3. The clear, concise and effective obligation does not mean advisers can leave out mandatory information from the SOA. Advisers should present the information in as brief a manner as reasonably possible, without compromising its accuracy.
4. The most important information in an SOA should be highlighted, particularly when the SOA is long (e.g. more than 10 pages).
5. The longer the SOA, the more important will be the inclusion of navigational aids (e.g. table of contents).
6. Avoid legal, industry or technical jargons, especially where advice is provided to relatively unsophisticated clients.
7. There is no "correct" format for an SOA. Consumer testing can help advisers assess the effectiveness of various disclosure formats.

ASIC also issued a new class order [CO04/576] *Statements of Additional Advice* on 21 July 2004 to facilitate shorter SOAs where the adviser has an ongoing relationship with the client. The new class order gives relief to permit SOAs to "incorporate by reference" certain information that the client has already received in a previous SOA, subject to certain conditions.

Briefly, ASIC expects the Statement of Additional Advice to:

- be dated;
- inform the client that it must be read with the original SOA (a copy of the original SOA must be provided free of charge if requested);
- contain new advice and supporting information which has been provided since the original SOA;
- highlight any changes since the original SOA; and
- repeat any required warnings and additional information required if recommending a replacement of one product with another.

### Relief for insurance broker trust accounts

ASIC announced interim class order relief on 9 July 2004 that permits insurance brokers to pay monies that are received in a single payment from a client into an

account that must be established and maintained under section 981B of the Corporations Act. The interim relief expires on 30 June 2005 (see Class Order [CO04/673]) and revokes Class Order [CO04/189]). To rely on the interim relief, a person must:

- be an insurance broker (defined to be the holder of an AFS licence who is authorised to provide financial services relating to insurance products and who, in providing those services, predominantly acts on behalf of intending insureds);
- reasonably believe that the payment may comprise, in whole or in part, monies to which section 981A(1) applies;
- take all reasonable steps to identify non-client monies within five business days of such monies being paid into the account and, if the licensee is not able to so identify within that period, it must continue to take all reasonable steps to identify those monies; and
- pay out of the account any monies that the broker has identified as non-client monies as soon as reasonably practicable, and in all cases, within five business days of identifying the monies.

### IFSA bans certain “soft dollars” benefits

IFSA has just announced that as of 1 August 2004, all of its members in the financial services industry must comply with the *Industry Code of Practice on Alternative Forms of Remuneration in the Wealth Management Industry* (the “Code”). The Code prescribes additional disclosure obligations to those under the Corporations Act. In particular, the Code bans several types of alternative remuneration or “soft dollar” such as free travel and accommodation to conferences that are volume-sales related, free computers and/or office accommodation, free business tools and cash or gifts of any sort over the value of \$300. Other benefits such as entertainment over \$300, certain educative conferences with travel and accommodation and sponsorships must now be listed on a public register. Members can contact IFSA for further information or for a copy of the Code for a whistleblowing disclosure.

### Self-managed super funds (SMSFs)

The ATO has issued two publications in line with its objective to increase its supervision of SMSFs. The “Role and responsibilities of trustees” guide provides a useful background on the rules governing the operation of SMSFs, the trustee’s obligations and how the ATO ensures compliance of SMSFs with the law. The booklet entitled “DIY Super: It’s your money... but not yet!” achieves a similar objective. Both publications can be downloaded from the ATO’s website at [www.ato.gov.au/super](http://www.ato.gov.au/super)

Emily Nighjoy-Wong Lawyer  
e: [enighjoywong@ebsworth.com.au](mailto:enighjoywong@ebsworth.com.au)

Alisa Kwan Lawyer  
e: [akwan@ebsworth.com.au](mailto:akwan@ebsworth.com.au)

For more information, contact our Financial Services Team

<b>Peter Daley</b> Partner	e: <a href="mailto:pdaley@ebsworth.com.au">pdaley@ebsworth.com.au</a>	t: 61 7 3303 8812
<b>Ian Enright</b> Partner	e: <a href="mailto:ienright@ebsworth.com.au">ienright@ebsworth.com.au</a>	t: 61 3 8602 1015
<b>John Goulios</b> Partner	e: <a href="mailto:jgoulios@ebsworth.com.au">jgoulios@ebsworth.com.au</a>	t: 61 3 8624 2006
<b>Brett Macgillivray</b> Partner	e: <a href="mailto:bmacgillivray@ebsworth.com.au">bmacgillivray@ebsworth.com.au</a>	t: 61 3 8602 1040
<b>Peter MacKenzie</b> Partner	e: <a href="mailto:pmackenzie@ebsworth.com.au">pmackenzie@ebsworth.com.au</a>	t: 61 2 9234 2591
<b>Ann Newbrun</b> Partner	e: <a href="mailto:anewbrun@ebsworth.com.au">anewbrun@ebsworth.com.au</a>	t: 61 2 9234 2533
<b>Michael Neylan</b> Partner	e: <a href="mailto:mneylan@ebsworth.com.au">mneylan@ebsworth.com.au</a>	t: 61 2 9234 2312
<b>Brian Thomas</b> Partner	e: <a href="mailto:bthomas@ebsworth.com.au">bthomas@ebsworth.com.au</a>	t: 61 2 9234 2592

sydney melbourne brisbane

Ebsworth & Ebsworth Lawyers respects your privacy and allows only limited use and disclosure of personal information. A copy of our privacy policy is available on our website. This publication is not legal advice. Professional advice should be sought before applying the information to your particular circumstances. Liability limited by the Solicitors’ Scheme, approved under the *Professional Standards Act 1994* (NSW). We regularly produce publications to keep our clients up-to-date with important legal developments. If you do not wish to receive this publication in the future or if you would like to receive other publications, please email: [publications@ebsworth.com.au](mailto:publications@ebsworth.com.au) © Ebsworth & Ebsworth Lawyers 2004