

# financial services newsletter

*Regulation and Compliance*

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**Greg Drumm** AUSTRALIA & NEW ZEALAND BANKING CORPORATION LTD

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**Gregory Wong** DEACONS

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**Dr Pamela Hanrahan** CENTRE FOR CORPORATE LAW AND SECURITIES REGULATION, UNIVERSITY OF MELBOURNE

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# FSR Industry FORUM

## Financial services governance: three year review

Professor Michael Adams UNIVERSITY OF WESTERN SYDNEY; and  
Alice Klettner and Professor Thomas Clarke  
UTS CENTRE FOR CORPORATE GOVERNANCE

### Main points

- The study, entitled *The Changing Roles and Responsibilities of Company Boards and Directors*, has particular relevance to financial services classified industries, which made up the single largest group at 29 per cent of the sample set.
- There has been a refinement of risk management systems, including the establishment of risk committees for major subsidiaries and/or business units.
- The results suggest the standards of corporate governance in Australia, including financial services, are very high.
- Respondents identified a need to reduce duplication of regulation.
- There were clear concerns regarding the overlap of layers of regulation applying to both responsible entities in the superannuation area and listed entities within a group of companies.
- There is a need for streamlining of reporting systems, for example, the breach reporting system in financial services and the continuous disclosure regime for listed and other disclosing entities.

changes in thinking and behaviour rather than on quantitative measures of compliance. The research was carried out in partnership with Dibbs Abbott Stillman Lawyers and received funding from the Australian Research Council.

The ultimate aim of the project was to discover how corporate governance might add value to companies, in terms of both accountability and performance. In light of the changes made by companies, it considers whether Australia has found the right balance in its corporate governance regime. On the basis that both the costs and the benefits are difficult to precisely pin down, it is not an easy balancing act to achieve. Nevertheless, Australia appears to be on the right track in terms of developing a useful and well-balanced corporate governance system

The research was conducted over the period 2005–2007 and represents the most in-depth analysis of corporate governance practice yet completed in Australia. It involved interviews with corporate officers, mostly company secretaries and directors of companies. The sample consisted of leading members of the ASX, including BHP Billiton, National Australia Bank, Westpac, Fosters and Westfield; representatives of the ASX 300, including Adelaide Bank, Commander Communications and Transfield Services; small listed corporations, including Cheviot Bridge and Engin, as well as recently-listed companies; and a selection of international and private corporations. As a whole, this sample represented the life cycle of corporate governance from the basic problems of establishing a listed company, to developing extensive systems of performance and accountability in the



### Glossary of abbreviated terms

#### Legislation

*Anti-Money Laundering and Counter Terrorism Financing Act 2006* (Cth)  
▶ AML/CTF Act

*Australian Securities and Investments Commission Act 2001* (Cth) ▶ ASIC Act

*Corporations Act 2001* (Cth) ▶  
*Corporations Act*

*Corporations Regulations 2001* (Cth) ▶  
*Corporations Regulations*

#### Organisations

Australian Prudential Regulation Authority ▶ APRA

Australian Securities and Investments Commission ▶ ASIC

Australian Stock Exchange ▶ ASX

Australian Transaction Reports and Analysis Centre ▶ AUSTRAC

#### Other

Australian financial services licence ▶ AFS licence

Product disclosure statement ▶ PDS

### Background to the findings

This article extracts the findings of the broader study, examining the extent to which the Australian corporate governance reforms have caused changes at a practical level within companies, as applied to the financial services industry. The full study, entitled *The Changing Roles and Responsibilities of Company Boards and Directors*,<sup>1</sup> focused on qualitative

mature corporation. Financial services classified industries made up the single largest group at 29 per cent of the sample set.

The questions were broadly developed from the ASX Principles in consultation with workshop members, and explored recent changes in corporate governance structures and processes focusing on the changing behaviour and values of boards and directors.

## Summary of findings

For most companies, implementation of corporate governance regulation proved a gradual process of formalisation and improvement, rather than an outright transformation. Across all sectors of Australian businesses surveyed there was evidence of intelligent engagement in corporate governance and professionalism in its implementation. Engagement with the ASX Principles has proved a positive process in this sample of companies, and to a large extent they have tailored their corporate governance structures to fit the needs of the organisation. Risk management systems had an obvious value in improving information flow and promoting better decision-making.

The research clearly revealed that the corporate governance practices appropriate for a company change as the business grows and develops. The role of the board and directors changes over time and board composition ought to reflect the needs of the company rather than conforming to any particular formula.

### Financial service entities — main findings

In respect of financial services entities, five general themes emerged:

- development of subsidiary boards, to include independent directors, triggered by APRA requirements;
- refining of risk management systems, including the establishment of risk committees for major subsidiaries and/or business units;
- clear concerns regarding the overlap of layers of regulation applying to both responsible entities in the superannuation area and listed entities within a group of companies;

- a need for streamlining of reporting systems, for example, the breach reporting system in financial services and the continuous disclosure regime for listed and other disclosing entities;
- the fast pace of change in the financial services regulatory environment has led to a more complex and demanding corporate governance system, which has impacted particularly on the smaller companies.

### Corporate governance reform

The ultimate objective of the research was to provide valuable insights into the response of Australian corporations to recent regulatory reform. For some years, governments worldwide have actively increased corporate regulation in an attempt to reduce risk and restore the confidence of investors.

In Australia,<sup>2</sup> amendments to the *Corporations Act*, also known as CLERP 9, came into force in mid-2004, taking into account the results of the Royal Commission investigation into the collapse of HIH Insurance. In 2003 the ASX Principles were launched as a practical guide for listed companies. These have since been the focus of public consultation and a second edition was released in August 2007. The changes to the Principles are not substantial: they have been streamlined and clarified rather than fundamentally altered. An interviewee stated:

‘The major costs have been in regulatory compliance rather than corporate governance, if you can separate them out.’

Interviewees regarded the US corporate governance regulation as a different matter. All participants who had been affected by the *Sarbanes Oxley Act of 2002* (SOX), particularly because of a US listing, said that it was out of proportion and very costly. Perhaps the favourable view of the Australian regime is a consequence of the belief that the alternative could be a lot worse:

‘I don’t think Australia’s reforms are too bad. SOX is a great

overcompensation — the cost has been extraordinary. Certainly it’s cost us half a million and the ongoing things — internal and external auditors etc.’

One of the most surprising aspects of the research was the lack of concern over the costs involved in implementing corporate governance reform. The majority of participants said the costs had been minimal, although, often, after some thought they came up with indirect costs that could be linked to governance changes. Many respondents suggested the costs were largely upfront and would not be significant once the new governance systems were well established. The participants’ inability to provide specific cost information may be because expenses are amorphous and hard to identify.

The most common cost raised by participants was time, often their own personal time as sole company secretary in charge of governance and compliance, but also board time which they felt could perhaps be better spent on other matters:

‘Our direct costs have been small. Indirect costs include time taken on SOX and Basel II. It tends to bump things off — it would be a shame if corporate governance diminished the time spent on corporate strategy.’

The costs associated with reporting under continuous disclosure regime and the breach reporting requirements caused concern; in the words of one interviewee:

‘I struggle to ensure there is not excessive reporting or duplication. You need to get things dealt with at the appropriate levels.’

A distinguishing factor from financial services to other listed industries was this observation:

‘A director of a company has the reason of maximising shareholder value. A trustee has added responsibility but wants to make sure of compliance — they are not driven by personal gain.’

Offsetting the costs of implementing corporate governance changes were the benefits seen by companies. Again these were difficult to identify but tended to reflect the major changes that companies had made in risk management or reporting systems. Clearly they were taking advantage of the flexibility of the ASX Principles, only making significant changes in the areas where they saw value:

‘Certainly it has introduced discipline — a more disciplined approach to decision-making — which is a benefit to the company.’

### Conclusion

The results of this research suggest the standards of corporate governance in Australia are very high, in all sectors including financial services. Certainly as far as the majority of companies in the research sample were concerned, Australia has struck the right balance between self-regulation and black-letter law. However, some in the financial services sector seemed to feel they were over-regulated and had more requirements to comply with than other industries. In particular they identified a need to reduce duplication of regulation:

‘There are so many layers and they all overlap — the internal audit (which is external); the corporate governance audit, the investment committees, the scheme compliance committee and scheme compliance auditor, the financial auditor.’

There was much comparison with the US regime, which is generally thought to have failed in finding the right balance by being too prescriptive and costly for smaller companies. Overall, the ‘if not, why not’ regime permits flexibility and individuality but forces companies to consider and justify their practices.

**Research methodology**  
The research adopted a triangulated approach drawing upon three mutually reinforcing sources of data:

- (1) A series of semi-structured interviews held with representatives of a wide ranging sample of 67 companies.
- (2) Annual financial reports, company website information and other public statements on corporate governance released by each participating company.
- (3) A series of workshops with leading corporate governance practitioners held at different stages of the research, used to obtain advice and input on the research direction and questions, the data collected and the scope of the research.



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You may download a PDF of the report at: <[http://www.ccg.uts.edu.au/project\\_changingroles.htm](http://www.ccg.uts.edu.au/project_changingroles.htm)>.

### Endnotes

1. Further details of the research methodology can be found in the Final Report available on the UTS website at <[www.ccg.uts.edu.au/project\\_changingroles.htm](http://www.ccg.uts.edu.au/project_changingroles.htm)>. a PDF of the full report is available at <[http://www.ccg.uts.edu.au/project\\_changingroles.htm](http://www.ccg.uts.edu.au/project_changingroles.htm)>.

2. For comparison, in the US the *Sarbanes Oxley Act of 2002* was enacted in response to the costly disasters of Enron, WorldCom and other corporate failures. The UK issued an updated version of its *Combined Code on Corporate Governance* following the findings of the 2003 Higgs Report and, having conducted an extensive *Modern Company Law* review, issued the *Companies Act 2006* (UK) which revised the duties of company directors.

# FSR Bulletin BOARD

Michael Vrisakis FREEHILLS

## Can the incorporation by reference regime be utilised for the purposes of s 1012IA of the Corporations Act?

**Q:** Is information required under s 1012IA of the Corporations Act within the ambit of the incorporation by reference (IBR) Rules (*Corporations Regulations, reg 7.9.15DA*)?

**A:** Yes — in relation to how a provider (that is, a trustee of a master trust) might take advantage of the IBR Rules, there are two areas: the provision of a PDS for access to a financial product, prepared by the provider (s 1013FB(3)(b)(i)); and the provision of an integrated PDS (s 1013FB(6)).

In addition, where a provider provides a copy of an underlying PDS, IBR can be relevant to the content of that underlying PDS.

**Q:** *How does this work?*

**A:** Both these provisions require the provider to furnish PDS material. Under (1) above the provider must prepare a PDS for the underlying accessible financial product. In the preparation of the PDS, the provisions of Pt 7.9 apply, requiring information set out therein to be furnished in the PDS. The IBR Rules are activated.

Under (2), the provider must combine the PDS for the underlying accessible financial product in its own PDS. In doing so, the provisions of Pt 7.9 will similarly require certain information to be included in the provider's PDS.

**Q:** *But is the IBR permissible for the provider to use?*

**A:** Yes — the new s 1012IA(5)(aa) provides that the references in s 1013A(1) to the issuer of the financial product includes a reference to the provider. As the deemed issuer of the financial

product, under s 1013A(1), the provider will be under an obligation to prepare the PDS.

Under s 1013A(3), as a person who prepares or is required to prepare the PDS, the provider would be a responsible person. This then means that under s 1013C, various items of information and statements must be included, regardless of whether the provider elects to use the integrated PDS or prepares the underlying PDS (provider-prepared PDS). It should be noted, however, that where the integrated PDS is used, a standard PDS for the underlying product must be prepared; and where a provider-prepared PDS is used, only the information required to allow a retail client to 'understand the investment strategy under which the accessible financial product may be acquired by way of regulated acquisition' needs to be included in that PDS.

**Q:** *What information can then be IBR-ed?*

**A:** In essence, it will be exactly the same information that can be IBR-ed in the provider's own PDS. As you will be aware, various kinds of information cannot be excluded. For present purposes, the main items that cannot be IBR-ed and which require some judgment on the part of the provider are:

- a summarised description of the purpose and key features of the product; and
- a summarised description of the key risks of the product.

It is more than likely that the underlying issuer will already produce such a summary.

**Q:** *Can other information required by s 1012IA (as modified by the Class Order) be IBR-ed?*

**A:** Yes — to the extent it is information required to be included in the PDS. This conclusion depends on 'information' extending to not just the specific mention of 'information' under s 1013D, but a more general concept of 'information'. Prima facie, the application of IBR may be seen to extend to information required to be included in the PDS by virtue of s 1013FB(3)(b) (namely, informing people of the right to get an accessible PDS or provider-prepared PDS). But this interpretation seems problematic, and in our view should not prudently be relied on (as it will effectively defeat the purpose of the need to tell people of their right to obtain an accessible PDS).

On the other hand, with an integrated PDS, the information required to be included (under s 1013FB(6)) would be capable of being IBR-ed (namely 'the information that a person would reasonably require as a retail client to understand the investment strategy under which the accessible financial product may be acquired by way of a regulated acquisition').

**Q:** *How does the IBR compare to electronic disclosure of underlying PDSs to investors?*

**A:** Favourably — it could be used in either the integrated PDS or the provider-prepared PDS, as an alternative to the accessible PDS. This would work on the following basis:

- some more information would need to be included in the main PDS in the case of the integrated PDS or provider-prepared PDS;
- the accessible PDSs would not be provided; and
- the bulk of the information otherwise required could be IBR-ed.

**Q:** *How, then, would changes to the accessible financial product information be dealt with?*

**A:** The key issue is whether future information, such as changes to an underlying PDS, can be IBR-ed (see below). Clearly, if a supplementary

PDS or new PDS issued by the underlying issuer is used as the source of IBR, then it may be difficult to satisfy the requirements of the IBR rules to, for example, identify the changed information by a unique identifier. It may simply be easier to utilise the mechanisms in the class order to get investors to agree to have the information provided electronically.

Of course, there is a larger issue associated with IBR-ing material which is updated in the underlying source. This is, technically, that information is new and would serve to generate a new PDS each time information (at least material information) changes; Class Order 03/237 would not necessarily change this position as IBR, by definition, deems the new content

to be contained in the PDS. This appears to be an unintended consequence of the new regime and one which presumably can be dealt with legislatively.



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## 'Better Regulation' for AFS licensees

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### Main points

- ASIC has released two new regulatory guides:
  - Regulatory Guide 104: *Licensing: Meeting the general obligations* (RG 104) and
  - Regulatory Guide 105: *Licensing: Organisational competence* (RG 105),which deal with ASIC's approach to the general obligations imposed on AFS licensees under s 912A(1) of the *Corporations Act*.
- RG 104 and RG 105 replace ASIC's previous Regulatory Guide 164: *Licensing: Organisational capacities* (RG 164) and Regulatory Guide 130: *Management Investments: Licensing* (RG 130).

On 11 October 2007, ASIC released two regulatory guides which relate to the general obligations of AFS licensees contained in s 912A of the *Corporations Act*. ASIC's release forms part of ASIC's 'Better Regulation' initiatives announced in April 2006 which, among other things, aim to improve accessibility to ASIC documents and decisions and, ultimately, to make ASIC regulation and publications clearer and easier to comprehend for AFS licensees.

### New regulatory guides

The two regulatory guides, RG 104 and RG 105, aim to use 'simpler language' to clearly and concisely communicate ASIC's approach to the

general obligations of AFS licensees and organisational competence, and to clarify, consolidate and harmonise ASIC's policy on these obligations. In doing this, RG 104 and RG 105 replace ASIC's previous Regulatory Guide 164: *Licensing: Organisational capacities* (RG 164) and Regulatory Guide 130: *Management Investments: Licensing* (RG 130).

### RG 104

Section 912A(1) of the *Corporations Act* prescribes the general obligations imposed on an AFS licensee from the time an AFS licence is granted and on an ongoing basis, and which include (but are not limited to) obligations to:

- do all things necessary to ensure that financial services are provided efficiently, honestly and fairly (s 912A(1)(a));
- comply with AFS licence conditions (s 912A(1)(b)) and financial services laws (s 912A(1)(c)); and
- ensure representatives are adequately trained and competent to provide financial services under an AFS licence (s 912A(1)(f)).

These general obligations are aimed at promoting 'consumer confidence in financial services and the provision of efficient, honest and fair financial services by all licensees and their representatives'.<sup>1</sup>

AFS licensees or applicants have the overriding responsibility for deciding how to comply with these general obligations. To assist AFS licensees to comply, however, RG 104 provides them with an outline of ASIC's general approach to an AFS licensee's obligations under

s 912A(1) of the *Corporations Act* and the particulars that ASIC considers when it assesses compliance with the various general obligations of an AFS licensee. It also sets out ASIC's policy on particular s 912A(1) obligations relating to compliance, risk management, representatives and resources.

### RG 105

Section 912A(1)(e) of the *Corporations Act* requires AFS licensees to maintain the competence to provide the financial services covered under the relevant AFS licence (referred to by ASIC as the 'organisational competence obligation'). AFS licence applicants have the obligation to demonstrate in their application that they are able to comply with this requirement. Compliance with this obligation is assessed by reference to the knowledge and skills of people who manage the AFS licensee's business.

RG 105 outlines what ASIC considers when assessing the organisational competence obligation of an AFS licensee and 'consolidates and harmonises'<sup>2</sup> ASIC's guidance on the organisational competence obligation, which was previously contained in RG 164, RG 130 and other related ASIC publications.

### Impact on AFS licensee

The introduction of RG 104 and RG 105 includes some minor adjustments to ASIC's policy relating to an AFS licensee's obligations; but, overall, the new regulatory guides largely reflect ASIC's policy previously contained in RG 164 and RG 130.

**National and international standards**

RG 104 refers to various industry and Australian standards and international principles as a relevant tool for AFS licensees to consider when trying to think about their obligations and design measures for ensuring compliance with these obligations. ASIC directs AFS licensees to resources produced by organisations such as the International Organisation of Securities Commissions and APRA, as well as various Australian and New Zealand Standards. ASIC views these standards as a guide to good industry practice, but notes that ASIC will continue to check compliance with the law and AFS licence conditions, but not compliance with such standards.

**Responsible managers**

RG 105 has replaced the term ‘responsible officer’ (as used under RG 164) with the term ‘responsible manager’ to identify the category of people ASIC looks at when assessing organisational competence. The change aims to clarify the position that the people that ASIC look at for organisational competence purposes do not need to be ‘officers’ of the AFS licence applicant or ‘responsible officers’ as defined under s 9 of the *Corporations Act*. It would seem that this clarification in position by ASIC is a recognition of the growing demand from AFS licensees to outsource the role of

responsible manager where an AFS licensee would otherwise not meet ASIC’s organisational competence requirements.

Any person who was a responsible officer for the purposes of RG 164 or RG 130 is now taken to be a ‘responsible manager’.

**APRA-regulated AFS licensees**

RG 105 clarifies how ASIC’s policy on organisational competence applies to AFS licensees who are regulated by both APRA and ASIC. RG 105 explains that ASIC will accept a standard set by APRA where the AFS licensee is regulated by APRA and the standard is relevant to the responsible manager’s role. For example, where the AFS licensee is regulated by APRA and conducts a general insurance business, ASIC will accept that a responsible person, for the purposes of APRA’s Prudential Standards GPS 520: *Fit and Proper*, has appropriate knowledge about dealing in general insurance products for the purposes of an AFS licence.

**ASIC’s approach**

The changes contained in RG 104 and RG 105 are effective immediately. However, ASIC has stated that it accepts it may take some time for existing AFS licensees to amend internal policies and procedures to reflect references to the new regulatory guides. ASIC expects, however,

that all AFS licensees will update these references the next time their internal policies and procedures are reviewed.

For applicants or AFS licensees who, at October 2007 had already started or lodged an AFS licence application or a variation application, ASIC has stated that it will not refuse the application simply because it refers to RG 164 and/or RG 130. However, ASIC expects applicants who are only beginning to prepare their AFS licence application to take into account the guidance provided in RG 104 and RG 105 (and not that in RG 164 and RG 130) when preparing their application and supporting ‘proof’ documents.



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**Endnotes**

1. ASIC, Information Release IR 07-45: *ASIC updates guidance on licensee obligations*, 11 October 2007.
2. ASIC, Regulatory Guide 105: *Licensing: Organisational competence*, October 2007, at p 7 (RG 105.19).

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**Privacy review — Australian Law Reform Commission  
Discussion Paper 72**

**Greg Drumm**

AUSTRALIA & NEW ZEALAND BANKING CORPORATION LTD

**Main points**

- The ALRC:
  - supports the practice of human review of decisions made by automated means because research indicates that computer software and hardware may not necessarily produce accurate and reliable results;
  - has proposed that where an application for credit is refused, the information to be given to the applicant should include any credit score or ranking used by the credit provider, together with explanatory material to allow the individual to understand how his or her application was assessed; and
  - recommends more comprehensive credit reporting by including additional information in the credit information file and allowing credit providers access to this information on the basis of reciprocity.

The Australian Law Reform Commission (ALRC) has undertaken a review of the *Privacy Act 1988* (Cth) and privacy generally (the review). The review was commissioned by the Commonwealth Attorney-General in part because of rapid changes in technology and also possible changing community perceptions on privacy. The result is a 2000-page discussion paper<sup>1</sup> raising questions and providing recommendations. Further public submissions are invited by 7 December 2007 with an expectation that the ALRC will report to Parliament at the end of March 2008.

The purpose of this article is to review three areas: the ALRC's support for human review of decisions and the proposals for applicants to be given their credit score when credit is declined and for more comprehensive credit reporting.

## Human review of automated decision systems

There are many areas where automated decisions are now made. In financial institutions, automated decisions are common, ranging from straightforward situations, such as whether to dispense cash from an ATM on the basis of available funds in a bank account, to more complex situations, such as determining eligibility for credit.

The benefits of automated decision systems are well-established. An automated compensation claims processing system in the Department of Veterans' Affairs allowed 30 per cent fewer officers to process 30 per cent more claims and reduced decision time by 60 per cent.<sup>2</sup> However, systems are not necessarily error-free and the decision made can have far reaching consequences for an individual, such as loss of entitlement to government financial support or a refusal to provide credit.

In Chapter 7.106 of the review, the ALRC supports the practice of human review of decisions made by automated means, particularly where the agency or organisation intends to take adverse action against an individual on the basis of the decision. The ALRC does so because of research that indicates that computer software and hardware may not necessarily produce accurate

and reliable results. The ALRC notes, however, that at present it has received insufficient feedback to propose a prescriptive requirement for human review.

An illustration of what this may mean could be provided in the UK's *Data Protection Act 1998*. Under that Act, where a decision significantly affects an individual and was made solely on the automatic processing of data, the individual must be advised accordingly and is given 21 days to ask for the decision to be reconsidered or for a new decision to be taken that is not made solely by automatic means.

The United Kingdom legislation also allows an individual to give notice to require that no decision which significantly affects that individual is made solely by automatic processing of data. This legislation and the EU Directive<sup>3</sup> on which it is based are considered by the ALRC but no recommendation is made in relation to it.

## Access to credit scores

Chapter 55.36 of the review describes credit scoring as the use of 'mathematical algorithms or statistical programmes that determine the probable repayments of debts by consumers, this assigning a score to an individual based on the information processed from a number of stat sources'. As a result of an insufficient credit score, an application for credit by an individual will be refused.

In Australia, credit scoring is widely used by banks and also by other organisations, such as mobile phone companies. Generally, the systems have been developed by individual banks and it can be very difficult for an applicant to know in advance if he or she will obtain a satisfactory credit score from a particular lender.

In other countries there are also many different ways of calculating a credit score, but in some, such as the US, there are also standard credit scoring systems — such as FICO — across the financial services industry. FICO is a credit scoring system developed by Fair Isaac Inc that is used by more than 90 per cent of the larger US banks, although there is no single 'cut off' score used by all lenders, and other factors may be taken into

account when making a credit decision. Individuals are able to assess their own likely FICO score,<sup>4</sup> get their actual FICO score<sup>5</sup> and even obtain help to improve their FICO score.<sup>6</sup>

The ALRC has proposed<sup>7</sup> that where an application for credit is refused, the information to be given to the applicant should include any credit score or ranking used by the credit provider, together with explanatory material to allow the individual to understand how his or her application was assessed.

## More comprehensive credit reporting

Credit reporting is where information about an individual's credit-worthiness is provided to credit providers, such as banks, to allow them to make a decision about that person's application for credit.

The information comprising a credit report is usually obtained from specialist credit reporting agencies. Most of us will be familiar with at least one of Australia's major credit reporting agencies — Veda Advantage and Dun and Bradstreet. They, in turn, source their information from credit providers and public information, such as that provided by the Insolvency and Trustee Service Australia about bankrupts. The ALRC reports<sup>8</sup> that Veda Advantage claims to hold credit-worthiness related data on more than 13 million individuals in Australia and NZ, and has over 5000 subscribers.

The information that a credit information file may hold is limited, in overview, to information necessary to identify the individual, and a record of any application for credit and any default in payment. In general, this information may only be disclosed to a defined credit provider. The use that a defined credit provider may make of the credit information is also limited, essentially to assessing a person's application for credit.

In industry terms, this type of credit reporting regime is often referred to as 'negative' credit reporting because all such a report can provide is information that is adverse to the applicant, such as defaults, or at best ambiguous. For example, a report might show that a number of credit providers have also requested credit

reports on the applicant. This could indicate the applicant is either over-committed if all these requests resulted in the provision of credit, or prudent in seeking a number of offers with the intention of accepting only the most favourable one.

The alternative model is often referred to as 'positive' credit reporting. This means that information about an individual's current credit commitments would also be collected. A 'positive' credit report would therefore allow a credit provider to assess the applicant's capacity, because all the applicant's actual credit commitments would be disclosed in the report.

The principal benefit of a 'positive' regime is improved risk assessment by providing more accurate information about an applicant's capacity to repay. The principal disadvantage relates to privacy concerns about more personal information being collected and the possible use of this information for marketing purposes.

The ALRC considers in Chapter 51 of the review the empirical studies (while also noting their limitations), the credit reporting regimes of similar jurisdictions and the various models of credit

reporting. Following this consideration, it recommends<sup>9</sup> more comprehensive credit reporting by including additional information in the credit information file and allowing credit providers access to this information on the basis of reciprocity. The additional information would be information about the type of credit; and the credit limit and the dates the credit account was opened and closed. Reciprocity means credit providers could only have access to the same categories of information that they provide to the credit reporting agency. As a safeguard, the credit reporting regime would be reviewed after five years of operation.

The use or disclosure of the information in a credit information file would be extended to other purposes within the reasonable expectations of the individual concerned, but use or disclosure for direct marketing would be expressly prohibited. Concerns about direct marketing were one reason why more comprehensive credit reporting in the UK took some time to occur and the ALRC notes<sup>10</sup> that submissions and consultation agreed that credit reporting information should not be available for direct marketing.



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*The views in this article are those of the author and not necessarily those of ANZ.*

### Endnotes

1. Discussion Paper 72, review of Australian Privacy Law.
2. See the address by Professor John McMillan to the Institute of Public Administration of Australia, Canberra, 23 April 2007.
3. Directive 95/46/EC (1995) European Parliament, *Directive on the Protection of Individuals with Regards to the Processing of Personal Data and on the Free Movement of Such Data*.
4. See, for example, <[Bankrate.com](http://Bankrate.com)>.
5. <[www.myFICO.com](http://www.myFICO.com)>.
6. See, for example, <[www.debtthelpcoach.com](http://www.debtthelpcoach.com)>.
7. Proposal 55-3.
8. Chapter 48.22.
9. Proposal 51-1.
10. Chapter 53.59.

# Regulatory changes may assist foreign financial service providers

Gregory Wong DEACONS

**Main points**

- At present, only a limited number of foreign entities are exempt from holding a licence for providing financial services in Australia by relying on an exemption under an ASIC class order or the legislation, due to the restrictive conditions attached to such exemptions.
- There is a proposal to broaden the existing exemptions, so that foreign entities providing financial services in Australia to a licence holder (or certain other exempted persons) who is a wholesale client and acting on someone else's behalf (as a trustee or responsible entity of a registered managed investment scheme) will

also be exempt from holding a licence. This will be applicable, for example, to a foreign fund manager accepting investments from local funds.

### Existing ASIC relief for foreign financial service providers

At present, certain foreign entities providing financial services to wholesale clients in Australia are exempt from holding an AFS licence by relying on the exemptions pursuant to RG 176 (and associated class orders).

However, not all foreign financial service providers can take advantage of these exemptions, as they are only available to foreign financial service

providers who are domicile in:

- the UK, and regulated by the UK Financial Services Authority (see Class Order 03/1099);
- the US, and regulated by the US Securities and Exchange Commission or the US Federal Reserve Board, the Comptroller of the Currency or the Commodity Futures Trading Commission (see Class Orders 03/1100, 03/1101 and 04/829);
- Singapore, and regulated by the Monetary Authority of Singapore (see Class Order 03/1102);
- Hong Kong, and regulated by the HK Securities and Futures Commission (see Class Order 03/1103); and

- Germany, and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht (see Class Order 04/1313).

Furthermore, there are differences in the financial services and financial products which are exempt under each specific relief. For example, all the class orders provide an exemption from the need to hold an AFS licence for the provision of custodial and depository services except for Class Order 03/1103 relating to service providers who are domiciled in Hong Kong and regulated by the HK Securities and Futures Commission. Therefore, if the fund manager is a Hong Kong entity regulated by the HK Securities and Futures Commission, it may need to consider outsourcing this function to a custodian in Australia who holds an AFS licence with the appropriate authority. The fund manager needs to ensure that the arrangements with an external custodian are sufficient to ensure that the fund manager is not regarded as also providing a custodial or depository service.

Even if a foreign financial service provider is able to take advantage of such an exemption from holding an AFS licence, it will still need to comply with certain ongoing notification requirements to ASIC under the relevant class order. These ongoing notification requirements may be burdensome for some financial service providers.

## Alternative exemption under the legislation

Not all foreign financial service providers providing financial services in Australia are required to rely on the relief from holding an AFS licence under the class orders.

Subsection 911A(2C) of the *Corporations Act*, which has recently been inserted by reg 7.6.02AG of the *Corporations Regulations*, sets out an exemption from the requirement to hold an AFS licence for a foreign financial services provider who provides a financial service to:

- a holder of an AFS licence; or
- a person exempt from the need to hold an AFS licence under s 911A(2)(h) of the *Corporations Act* (exempt person).

Under the *Corporations Act*, a person is an 'exempt person' if the following conditions are satisfied:

- the person is regulated by an overseas regulatory authority;
- the provision of the financial service by the person is covered by an exemption specified by ASIC in writing and published in the Gazette; and
- the financial service is only provided to wholesale clients.

For the exemption under s 911A(2C) of the *Corporations Act* to apply, the relevant AFS licensee or exempt person must not be acting as a trustee, responsible entity of a registered managed investment scheme or otherwise on someone else's behalf in relation to the relevant financial service.

This exemption is currently available to all foreign financial service providers and is not limited to certain foreign financial service providers from specific jurisdictions. Foreign financial service providers that may take advantage of this exemption include foreign investment managers managing (on balance sheet) portfolios of certain local clients where the local client is a corporate that is not a trustee.

However, this exemption is not available in more common situations where a foreign fund manager invites and accepts investments from local investment funds.

## Proposed changes to legislation

In March 2007, Treasury proposed amendments to reg 7.6.02AG modifying the operation of s 911A(2C) of the *Corporations Act*.

These proposed amendments exempt a foreign financial service provider from the requirement to hold an AFS licence if it provides a financial service to an AFS licence holder or an Exempt Person and the AFS licence holder or Exempt Person is:

- a wholesale client in relation to the relevant financial service; and
- acting on someone else's behalf in relation to the service as a trustee or a responsible entity of a registered scheme.

The application of these proposed amendments is broader than the

current exemption under the legislation. If and when these amendments take effect, the exemption will apply to a foreign fund manager that invites and accepts investments from local investment funds and would permit a foreign investment manager to manage portfolios of local funds.

There is a clear policy shift from the limited exemption under the class orders to the exemption under the proposed amendment. The exemption under the class orders focuses on the 'quality' of the foreign financial service providers and only applies to those who are regulated by certain regulatory bodies approved by ASIC. However, the proposed exemption applies to all foreign financial service providers (whether they are regulated by an overseas regulatory body or not). Increased reliance is placed on the local licensed recipient of the services to assess the quality of financial service being provided by foreign financial service providers.

## What now?

If you are a foreign financial service provider who is currently relying on an AFS licence exemption under a class order, you would have received a letter from ASIC informing you of these legislative changes. If you are not able to rely on the current AFS licence exemption under the legislation outlined above and you wish to continue to rely on the AFS licence exemption in the class order, you were required to provide certain information to ASIC in relation to the financial services you provide in Australia by 10 October 2007. If you have yet to reply to ASIC, you will need to do so as a matter of urgency.

However, if you are a foreign financial service provider who is currently relying on an AFS licence exemption under a class order and have not received such a letter from ASIC, you should contact ASIC immediately. It is best to contact them by sending an email to <[ffsp@asic.gov.au](mailto:ffsp@asic.gov.au)>.



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# Understanding directors' personal accountability in funds management companies

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Thinking (and writing) about the duties and liabilities of directors and other officers of funds management companies raises two obvious questions. First, given the variety of institutional forms within which funds management in Australia takes place, is it possible to talk in general terms about officers' accountability across the industry as a whole? Second, are the duties and liabilities of officers of funds management companies sufficiently different from those that arise under general company law principles to justify separate analysis? The answer to both those questions is 'yes', but qualified in some respects.

It is true that funds management in Australia takes place through a variety of institutional forms. Funds management services may be provided to (retail and wholesale) clients either through the clients' participation in a collective investment vehicle operated by the fund manager, or by way of an agreement between the fund manager and the client for the management of the client's discrete portfolio of assets. Collective investment vehicles operated by Australian fund managers include investment companies, managed investment schemes, superannuation funds and life insurance company statutory funds. Each is structured differently and operates under its own indigenous law (company law, trust law or contract law as the case may be) and under the specific governance regime provided for in relevant Commonwealth law (respectively, Chs 2A–2N and 5C of the *Corporations Act*, the *Supervision Industry (Supervision) Act 1993* (SIS Act) and the *Life Insurance Act* 1995). What they have in common, though, is that the provision of funds management services (whether through a collective investment vehicle or under an

individual investment mandate) usually involves the provision of financial services, meaning that the funds management industry as a whole is subject to regulation under Ch 7 of the *Corporations Act* (which regulates financial services and the offer of financial products) and Div 2, Pt 2 of the ASIC Act (which contains the consumer protection and unconscionable conduct law for the financial sector).

Across the different institutional forms, the duties and liabilities of the company's directors and other officers in relation to the operation of the funds management business differ in many important respects. In particular, the specific governance regimes that apply to the different types of collective investment directly affect the directors' duties and liabilities in relation to the company's funds management business. For example, officers of responsible entities of registered managed investment schemes are subject to specific duties contained in s 601FD of the *Corporations Act*. Directors of superannuation trustees are bound by a covenant in s 52 of the SIS Act to use reasonable care to ensure that that trustee carries out the various covenants to which it is subject under the Act. Directors of life insurance companies are subject to particular duties in relation to the management of the company's statutory fund, under s 48 of the Life Insurance Act.

Given these differences, is it worthwhile to reflect on the nature and extent of officers' accountability across whole of the funds management sector?

While the directors' specific duties may be different across the different institutional forms, it is possible to discern a common 'architecture' of accountability in relation to officers of funds management companies

generally. Officers of funds management companies risk being held personally accountable in connection with the operation of the company's funds management business if they:

- engage in unauthorised funds management activities (for example, operating an unregistered scheme in contravention of s 601ED or providing financial services without a licence in contravention of s 911A or 911B of the *Corporations Act*);
- engage in conduct that breaches their duties *qua* officers to the company itself, including under Ch 2D of the *Corporations Act* and the general law;
- engage in conduct that breaches their statutory duties in relation to the provision of financial services, under Ch 7 of the *Corporations Act* and Div 2, Pt 2 of the ASIC Act;
- engage in conduct that breaches their statutory and equitable duties in relation to the operation of the relevant funds management vehicle itself, including s 601FD of the *Corporations Act*, ss 52 and 53 of the SIS Act, ss 48, 50 and 188 of the *Life Insurance Act*, or under the rule proscribing dealings by a trust company's directors in *Ex parte James* (1803) 32 ER 358;
- participate in breaches of law or duty by the company (for example, by being complicit in the commission of an offence by the company within the meaning of Pt 11.2 of the *Commonwealth Criminal Code*, by being 'involved in a contravention' of a relevant provision of the *Corporations Act* or the SIS Act giving rise to civil liability, or by contravening the 'knowing assistance' limb of the rule in *Barnes v Addy* (1874) LR 9 Ch App 244);
- engage in misleading or deceptive conduct or other information failures in contravention of Pt 7.10 of the

*Corporations Act* or Div 2, Part 2 of the ASIC Act or of the specific disclosure regimes covering prospectuses, PDSs, takeover documents, periodic financial reporting and continuous disclosure; or

- incur debts in relation to the funds management arrangement that are in

breach of trust (where that applies) or that result in the company's insolvency, under s 197 and s 588G of the *Corporations Act* respectively. These seven distinct heads of accountability provide the foundation for answering 'yes' to the second of the two question proposed above.



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## Funds Management in Australia: Officers' Duties and Liabilities

is a new work authored by Pamela Hanrahan.

It provides a detailed analysis of the law as it applies to directors and other officers of Australia's commercial funds management companies.

Drawing on Dr Hanrahan's unique combination of academic and practical expertise, the work deals comprehensively with officers' duties and liabilities in relation to the main forms of commercial funds management in Australia, including superannuation, life insurance, managed funds and investment mandates.

For information, freecall 1800 772 772 or visit <[www.lexisnexis.com.au](http://www.lexisnexis.com.au)>.

# FSN



# NEWS

## ASIC

### ASIC updates guidance on licensee obligations

On 11 October 2007, ASIC released two regulatory guides about the general obligations of Australian financial services (AFS) licensees under s 912A of the *Corporations Act*. Regulatory Guide 104: *Licensing: Meeting the general obligations (RG 104)* and Regulatory Guide 105: *Licensing: Organisational competence (RG 105)* are part of ASIC's Better Regulation initiatives, which are designed to achieve better and more transparent regulation. See the article by Vanessa Pallone and Fadi C Khoury entitled "Better Regulation" for AFS licensees' on p XX for details.  
Source: IR 07-45.

### Better disclosure for unlisted and unrated debentures

As part of its progress in implementing its 'Three Point Plan'

for the unlisted and unrated debenture market, announced at a hearing of the Senate Standing Committee on Economics on 30 May 2007, ASIC has:

- released Regulatory Guide 69: *Improving disclosure for retail investors (RG 69)*, outlining its benchmarks (and reporting on an 'if not, why not' basis) to improve disclosure to retail investors;
- released Consultation Paper 94: *Debenture advertising (CP 94)*, which includes a draft regulatory guide on debenture advertising for issuers and publishers; and
- provided an update on investor research and education on unlisted and unrated debentures.

A copy of RG 69 and CP 94 can be downloaded from the ASIC website at <[www.asic.gov.au](http://www.asic.gov.au)>.

Source: MR 07-280 31 October 2007.

## IFSA/FPA

### Guidance for managing member obligations under the AML/CTF regime

On 14 November 2007, IFSA and the Financial Planning Association (FPA) released a guidance package that standardises and streamlines the application of legislative requirements applying to both financial planners and product issuers under the AML/CTF regime and will assist members of both organisations to comply with the regime from 12 December 2007. The guidance seeks to remove potential duplication under the AML/CTF regime and encourage the use of a common set of processes and procedures. It includes recommended procedures and record keeping documentation for financial planners to fulfil their customer identification requirements for each customer category. Record keeping obligations for financial planners who provide customer identification information and verification to product issuers, are also addressed in the guidance  
Sources: <[www.ifsa.com.au](http://www.ifsa.com.au)> and <[www.fpa.asn.au](http://www.fpa.asn.au)>.

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