Thomsons Lawyers

Funds Management & Financial Services: Quarterly Review

September 2012

Editorial

Welcome to the September 2012 edition of Thomsons' quarterly review of legal developments in the funds management and financial services sector.

Legislative reform has continued apace over the quarter, with two substantive Future of Financial Advice (**FOFA**) bills being passed by the Senate in June. While the laws commenced on 1 July 2012, there is an opt-in period of 12 months with compliance required by all entities from 1 July 2013.

In addition, the Corporations and Markets Advisory Committee (**CAMAC**) released its much-anticipated report into the operation of managed investment schemes in Australia following a number of high-profile collapses in the agribusiness sector. CAMAC has made some recommendations about how the law should be fundamentally changed to create a distinct legal personality for schemes.

We have also seen new financial requirements imposed on CFD issuers, the investment manager regime taking shape with the passing of new laws, a number of important decisions about when a responsible entity can unilaterally change a constitution and a decision which reminds us of the pitfalls of taking over a managed investment scheme as responsible entity.

You will find information about all of these things in this quarterly review. We hope you find it informative.

Regards,
Chris Mee

Special Counsel
+61 7 3338 7589
cmee@thomsonslawyers.com.au

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Important dates

13 September 2012: Thomsons to host Independent Compliance Committee Member Forum in Brisbane.

13 September 2012: Closing date for submissions on the Government's discussion paper about clean building managed investment trusts 10 per cent concessional tax rate.

14 September 2012: Closing date for submissions on the Government's trust reform proposals.

20 September 2012: Closing date for submissions on ASIC's FOFA proposals

31 October 2012: Last date by which all registered entities must apply for an AFS licence to participate in carbon markets.

1 November 2012: All responsible entities to have complied with ASIC's new financial requirements.

1 November 2012: All responsible entities of unlisted property funds to have disclosed new benchmark information to investors and in PDSs.

New proposals set to re-shape funds management industry

The Federal Government's chief advisory body on corporations law, the Corporations and Markets Advisory Committee (**CAMAC**), has recently published its much anticipated report on the operation of managed investment schemes in Australia.

Wide-sweeping reforms

The report contains a number of significant proposals, which, if adopted by the Federal Government, will radically transform the law relating to managed investment schemes.

Whilst the genesis of the report was the collapse of a number of agribusiness managed investment schemes following the global financial crisis (**GFC**), the terms of reference given to CAMAC extended its investigations to the operation of the managed investment scheme regime generally.

Key proposals

CAMAC's main proposals are as follows:

- (**Ban on common enterprise schemes**)—Most of the agribusiness schemes which collapsed during the GFC were contractual-based schemes or 'common enterprise' schemes.

  In a 'common enterprise' scheme, investors enter into a series of agreements with the responsible entity (**RE**) which relate to the ongoing operation of the scheme. For example, in agribusiness schemes structured as common enterprise schemes, investors would often enter into grower agreements to engage the RE or external parties to perform certain cultivation and management activities. Under the proposal, the creation of new common enterprise schemes would be banned.

  'Pooled schemes' would be permitted to continue to operate. 'Pooled schemes' are managed investment schemes which involve the pooling of contributions by scheme members which then become scheme property. In these types of schemes, the investors play no active role in the affairs of the scheme. This expression would cover most trust-based schemes.

- (**Separate Legal Entity (SLE) proposal**)—CAMAC has recommended that a new legal structure for managed investment schemes be adopted.

  Under this proposal, each scheme would be a separate legal entity, distinct from the RE or the members of the scheme. This is a fundamental change to the current law under which the scheme is not a separate legal entity and there is a trustee which holds scheme property on trust for the scheme members or which appoints a custodian to do so. Under the SLE proposal, the scheme would hold legal title to all scheme property and would be the principal in all agreements entered into by the RE as operator of the scheme.

  The reason this proposal has been made is to:

  - ensure the full separation of the property, affairs and liabilities of a scheme from those of its RE;
  - provide counterparties to agreements with direct rights against scheme property;
  - assist in the process of changing an RE of a fund as the incoming RE would not be subject to personal obligations and liabilities for agreements entered into by a former RE; and
  - simplify the external administration process for 'insolvent' schemes.

  CAMAC recommends that if the SLE proposal is adopted, that all existing schemes be required to convert to this new legal structure.

- (**one RE per scheme**)—If the SLE proposal is not adopted, then CAMAC recommends that each RE only be permitted to operate one scheme. This recommendation has been made because of the difficulties in disentangling the dealings of insolvent REs from their schemes.

- (**no poison pills**)—CAMAC has recommended that provisions in a scheme's constitution or in other agreements which have the effect of entrenching the incumbent RE should only be enforceable if they do not unreasonably inhibit the right of scheme members to replace the RE.

- (**voting requirements to remove the RE**)—CAMAC has recommended that the current voting threshold to remove an RE, that is, 50% of those members eligible to vote (whether or not cast), is reduced to a simple majority of votes actually cast (in person or by proxy) provided that the total of the votes cast (both for and against) constitutes at least 25% of the total votes of eligible scheme members.

- (**appointment of temporary REs**)—CAMAC has made a series of recommendations about making the process of appointing a temporary RE less restrictive, including granting the courts much wider powers to appoint a person as a temporary RE.

- (**defining an insolvent scheme**)—As part of its suggested reforms around insolvency of schemes, CAMAC has recommended that a statutory definition of what is an 'insolvent' scheme be included in the *Corporations Act 2001* (Cth) (**Act**). Under the current law, a scheme cannot technically be 'insolvent'. CAMAC says that an insolvent scheme is one where the scheme's property is insufficient to meet all the claims that can be made against that property as and when those claims become due and payable.

- (**introduction of a VA procedure for schemes**)—A scheme, not being a company, cannot currently be placed in voluntary administration. There is simply no provision for it under the Act. CAMAC supports the introduction of a voluntary administration procedure for schemes.

- **(reduced voting requirements for winding up)**— CAMAC has recommended that scheme members be able to approve the winding up of a scheme by 75% of the votes cast on the resolution, provided the votes in favour of the winding up constitute at least 25% of the total votes of scheme members. Currently, the legislation provides that a resolution to wind up a scheme requires the approval of 50% of the scheme's members entitled to vote (whether or not cast).
- **(statutory limited liability for scheme members)**— CAMAC has recommended that new legislation be introduced such that in the event of insolvency, scheme members should only be liable for the unpaid portion of the amount they have agreed to contribute to the scheme. Whilst CAMAC recognises that this limitation is generally contained in scheme constitutions, it believes adding a statutory limitation will give greater protection to scheme members and more certainty for scheme creditors.

An improved system

If the proposals are adopted, particularly the requirements that all existing schemes convert under the Separate Legal Entity proposal, then we will experience the same radical transformation we experienced when the *Managed Investments Act 1998* did away with the 'prescribed interest' regime and introduced the single responsible entity regime that exists today. It will also be an acknowledgement in some respects that our existing laws do not adequately deal with the widespread use of trusts as commercial vehicles.

However, while the changes might be transformational, they are also going to provide greater certainty for investors, scheme operators, creditors to schemes and those contracting with schemes. It will be an improved system overall.

CAMAC has stated that it intends to conduct further public consultation on proposals to further improve the operation of managed investment schemes. We will keep you informed of any further developments in this regard.

Need an AFS licence to participate in carbon markets?

Carbon emissions units are financial products from 1 July 2012

With the introduction of a carbon pricing mechanism on 1 July 2012 and the federal government's decision to treat carbon emissions units as financial products, participants in Australia's carbon markets must now consider whether they need to obtain an Australian Financial Services (AFS) licence to continue to operate their business.

Those entities which need an AFS licence and have registered with ASIC have until 31 October 2012 to apply for an AFS licence.

Which carbon emissions units are financial products?

Before you consider whether you need an AFS licence to participate in carbon markets, it is necessary to understand the kinds of carbon emissions units which are now treated as financial products. Under the current clean energy legislation, the following three types of carbon emissions units are recognised as financial products for the purposes of the AFS licensing regime:

- Carbon units. Carbon units are issued by the Clean Energy Regulator, the statutory authority which has responsibility for administering the carbon pricing mechanism and the Carbon Farming Initiative. Carbon units are likely to be the main type of emissions unit which emitters are likely to acquire for surrender purposes.
- Australian carbon credit units (ACCUs). ACCUs are generated through emissions off-set projects under the Carbon Farming Initiative and these kinds of emissions units are also issued by the Clean Energy Regulator.
- Eligible international emissions units (EIEUs). Australia's clean energy legislation also recognises certain types of international emissions units issued under the Kyoto Protocol. These EIEUs will also be financial products for the purpose of AFS licensing.

So if you are currently in the business of providing financial services in relation to these types of regulated emissions units, or you are planning to commence such a business, you are going to need an AFS licence unless an exemption applies.

What services are likely to be caught?

Given the nature of the carbon pricing mechanism, it is likely that participants in Australia's carbon markets may be involved in providing the following kinds of financial services:

- Providing financial product advice about regulated emissions units or derivatives over regulated emissions units.
- Dealing in regulated emissions units.
- Making a market in regulated emissions units or in derivatives over regulated emissions units (regulated emissions units futures, for example).

- Operating a managed investment scheme which holds or deals in regulated emission units.

Giving advice on regulated emissions units

Providing financial product advice about regulated emissions units means making a recommendation or providing a statement of opinion, or a report of either of those things, that is intended to influence a person in making a decision about a regulated emissions unit, or could reasonably be regarded as being intended to have such an influence.

Examples which ASIC cites as instances where financial product advice may be provided in respect of regulated emissions units are as follows:

- Advice to carbon emitters to assist them to make a decision about acquiring or disposing of regulated emissions units.
- Advice to people engaged in voluntary off-setting of their emissions about how to acquire or dispose of regulated emissions units for this purpose.
- Advice relating to a carbon off-set project in the context of the Carbon Farming Initiative, or in the context where a person is seeking to produce EIEUs through the development or operation of an international off-set project.
- Advice about regulated emissions units or products associated with emissions units (for example, derivatives or managed investment schemes).

Purely factual information given in relation to carbon markets will not generally constitute financial product advice. ASIC says an example of when financial product advice will not be given is where a person is informed of the settlement price of a future contract traded on the European Climate Exchange.

In addition, providing advice of a technical nature on off-set projects which does not relate directly to a regulated emissions unit would not be financial product advice. However, advice that is intended to influence a person's decision about the regulated emissions units emanating from that project is likely to be financial product advice.

Dealing in regulated emissions units

In financial services language, "dealing" in a financial product means applying for, acquiring, issuing, varying or disposing of a financial product or underwriting an offer of securities or interests in a managed investment scheme. Arranging for a person to "deal" in a financial product is also deemed to be "dealing" under our financial services law (with some limited exceptions).

However, if you are dealing in regulated emissions units on your own behalf, then you will not be considered to be dealing in a financial product. Examples of where you would be dealing on your own behalf include:

- If you are a carbon emitter and you are acquiring or disposing of regulated emissions units under the carbon pricing mechanism.
- Where you are generating regulated emissions units through your own activities in eligible off-set projects either in Australia or overseas.
- You are an investor trading on your own behalf in regulated emissions units.

Importantly, ASIC warns that the critical question in determining whether a person is dealing in a regulated emissions unit is not whether the activity relates to a particular emission trading scheme but simply whether the dealing involves a financial product that is a regulated emissions unit.

Making a market in regulated emissions units

A person will be making a market in regulated emissions units if they regularly state the prices at which they propose to buy or sell regulated emissions units on their own behalf, and other persons can reasonably expect to be able to regularly buy and sell at those stated prices. ASIC believes that carbon emitters who regularly state prices at which they will acquire regulated emissions units are likely to be making a market in relation to regulated emissions units and therefore require an AFS licence.

Operating a managed investment scheme

If a fund which is operating in the carbon market meets the definition of a managed investment scheme, then ASIC says it will be regulated in the same way as managed investment schemes that operate in other industry sectors. That is, if the scheme is one which requires registration, it must be operated by a public company which holds an AFS licence that enables it to operate that scheme.

But are you in the business?

Even if you believe you are likely to require an AFS licence on the basis of the information set out above, a fundamental question is whether or not you are carrying on a financial services business. If you are not carrying on

a financial services business in Australia, then you will not need an AFS licence to undertake activities in relation to Australia's carbon markets.

ASIC says that if the financial services you provide are more than very minor, then it is likely that you will need an AFS licence. In relation to when a person is carrying on a business in Australia, the courts have determined that when a body corporate's activities are conducted with system, regularity and continuity, its activities can generally be characterised as "carrying on a business in Australia".

Overseas entities also need to be cautious if they provide services to Australian clients in relation to carbon markets. Australia's financial services laws can deem such entities to be conducting a financial services business in Australia even when they have limited connection with Australia.

How can we help?

We can:

- advise you about whether your activities will require you to hold an AFS licence, and
- apply for and assist you to obtain an AFS licence for your activities.

Please contact Chris Mee on +61 7 3338 7589 or by email cmee@thomsonslawyers.com.au for more information.

Important cases

New responsible entity liable for personal obligations of old responsible entity

In *MacarthurCook Fund Management Ltd v Zhaofeng Funds Ltd*, the court considered the effect of an agreement between the former responsible entity of a fund and another party to redeem units in the fund.

Facts

Zhaofeng Funds Ltd (**Zhaofeng**) was the responsible entity of the Reed Property Trust (**Fund**). It entered into three agreements with MacarthurCook Fund Management Ltd (**MacarthurCook**) pursuant to which MacarthurCook agreed to subscribe for units in the Fund. Each agreement required Zhaofeng, in its capacity as responsible entity of the Fund to redeem the units and, if the units were not redeemed, then Zhaofeng was required to purchase those units (in its personal corporate capacity). Zhaofeng failed to comply with its obligations.

TFML Limited (**TFML**) then took over as responsible entity of the Fund. MacarthurCook sought damages for breach of contract from Zhaofeng and then TFML, on the basis TFML became liable to perform Zhaofeng's obligations under the agreements when it became responsible entity for the Fund.

Decision

TFML argued that redeeming MacarthurCook's units in accordance with the agreements would allow MacarthurCook to withdraw from the Fund otherwise than in accordance with the constitution, and therefore in breach of the Corporations Act.

TFML also argued that the obligation to purchase MacarthurCook's units was a personal obligation of Zhaofeng's and that it did not take on the obligation when it became the responsible entity.

The court found that:

- the responsible entity could not rely on the fact it might breach the Corporations Act as a reason for breaching its contractual obligations to MacarthurCook to redeem units;
- the responsible entity could enter into an agreement binding itself to make a withdrawal offer;
- the true substance of the agreements was that the responsible entity took on the obligation to purchase the units as responsible entity despite purporting to assume the obligations in its personal corporate capacity; and
- the obligation to purchase the units was 'in relation to' the Fund and so TFML inherited the obligation when it took over as responsible entity.

TFML was held to be liable to MacarthurCook for damages for failure to redeem the units in addition to finding that it was in breach of its contractual obligation to purchase the units.

Amendments to the constitution of a registered managed investment scheme

In both *Watts & Watts v 360 Capital RE Ltd* and *Re Elders Forestry Management Ltd* the court considered whether changes could be made to the constitution of a registered managed investment scheme without unitholder approval.

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Watts & Watts v 360 Capital RE Ltd

Facts

Watts involved the 360 Capital Industrial Fund (**360 Fund**), a registered managed investment scheme. 360 Capital RE Limited (**RE**) was the responsible entity of the scheme.

The RE sought to fund the acquisition of additional properties for the 360 Fund by issuing redeemable unsecured convertible notes. In order to issue the notes, 360 RE amended the constitution of the 360 Fund without member approval relying on section 601GC(1)(b) of the *Corporations Act 2001* which provides that the constitution of a registered managed investment scheme may be amended by the responsible entity if the responsible entity reasonably considers the change will not adversely affect members' rights.

A member of the 360 Fund challenged the right of the RE to make the changes unilaterally.

Decision

The judge referred to previous decisions about unilateral changes to a registered scheme's constitution, including the decision in *Premium Income Fund Action Group Incorporated v Wellington Capital Ltd* where the court found a constitutional amendment that altered the price at which new units could be issued adversely affected members' rights (and so required member approval).

In *Centro Retail Ltd & Centro MCS Manager Ltd,* the court held that a responsible entity may unilaterally amend a constitution to issue new units at a price different from the price prescribed by the constitution on the basis that the changes affected only the enjoyment of the rights attached to the existing units, not the rights themselves.

In finding for the member, the judge in *Watts* held the modification of the rights of 360 Fund members affected the characteristics and nature of the rights and not merely the enjoyment of those rights.

In addition, the judge in *Watts* held that the evidence did not establish that the RE gave due and proper consideration as to whether and to what extent members' rights would be affected and that the board of the RE appeared to have approached the matter in a mechanical fashion and accepted legal advice (that the changes would not adversely affect members' rights) without proper consideration.

Re Elders Forestry Management Ltd

Facts

In *Re Elders Forestry Management Ltd*, the responsible entity of a number of registered managed investment schemes sought to restructure its timber projects through the sale of certain plantations. Whilst the proceeds of sale would be distributed to scheme members, a condition of the sale was that amendments be made to the constitutions of the managed investment schemes to extinguish certain of the members' rights. The responsible entity believed the sale proceeds were likely to yield a better return than harvesting and selling the timber.

The responsible entity sought directions from the court in relation to the constitutional amendments proposed to be made under section 601GC(1)(b): that is, by the responsible entity unilaterally without a meeting of members.

Decision

The court referred to the decision in *ING Funds Management Ltd v ANZ Nominees Ltd*, where the court examined the meaning of the phrases "members' rights", "adversely affects" and the procedure that should be followed by a responsible entity to satisfy the obligation to "reasonably consider" the effect of an amendment to the constitution. In that case, the court held that members' rights are different from the value of those rights.

The judge in *Re Elders* gave the directions requested as he was satisfied that the responsible entity formed a reasonable basis for the view that the constitutional amendments would not adversely affect the members' rights.

Sector developments[1]

FOFA

FOFA reforms passed by the Senate

On 20 June 2012, the Senate passed the *Corporations Amendment (Future of Financial Advice) Bill 2012* and the *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2012*. The Government also moved amendments to the Senate to implement more flexible transition arrangements — while the FOFA reforms will still commence from 1 July 2012 as originally announced, the application of the provisions will be voluntary until 1 July 2013.

[1] The material in this section contains edited excerpts from Government and ASIC media releases.

The Government is also consulting on whether the term financial planner or adviser should be defined in the Corporations Act.

ASIC releases consultation papers on FOFA reforms

On 9 August 2012, ASIC released consultation papers containing proposed guidance for two aspects of the Future of Financial Advice (FOFA) reforms — scaled advice and the best interests duty.

Best interests duty

ASIC's proposed guidance on the best interests duty covers the following areas:

- acting in the best interests of the client;
- satisfying the "safe harbour" for the best interests duty — including providing guidance on each element of the safe harbour;
- providing appropriate personal advice; and
- prioritising the interests of the client.

It should be noted that the best interests duty obligations commence on 1 July 2013 however advice providers can choose to follow the requirements earlier (and if they do so, they must register with ASIC).

Scaled advice

ASIC's proposed guidance on scaled advice applies to all industry sectors, including superannuation, financial planners, banks and insurers, and includes practical guidance and examples about giving scaled personal advice, as well as practical examples about giving factual information and general advice to clients. The proposed guidance indicates:

- all advice is scaled to some extent — advice is either less complex or more complex along a continuous spectrum rather than there being two categories of advice such as "scaled" and "holistic";
- the same rules, including the best interests duty, apply to all personal advice, regardless of the scope; and
- it is possible to provide less complex advice in a way that is consistent with the best interests duty and the law generally.

Submissions on the proposed guidance closes on Thursday, 20 September 2012.

Application of FOFA to the timeshare industry

On 20 July 2012, the Government announced that the timeshare industry has been carved-out from the ban on conflicted remuneration under the FOFA reforms, allowing the industry to continue to remunerate employees through sales-based commissions.

Other aspects of the FOFA reforms, including the obligation to act in the best interests of clients, will continue to have application to the timeshare industry, where sales staff provide financial advice to clients.

Managed investment schemes

CAMAC report released

CAMAC has released its much-anticipated report into the operation of managed investment schemes in Australia. Please refer to our lead article for more information.

ASIC releases report into custodial and depository services

On 5 July 2012, ASIC released a report into custodial and depository services in Australia following a review of the industry.

The report identified a number of key risks to the safety of client assets including the following:

- unauthorised debiting of omnibus accounts;
- stability and safety of IT systems;
- operational risks created by manual and disparate systems;
- whistleblowing culture and framework;
- reporting in relation to suspicious third party valuations;
- breach reporting relating to custodial and investment administration services; and
- the risks inherent in corporate actions such as share buy-backs and rights issues.

The report also foreshadows ASIC's intention to consult with industry about updating its regulatory guidance for the holding of scheme property. In addition, ASIC is proposing changes to the financial resource requirements of custodians and will require responsible entities and other financial product issuers to provide clearer disclosure about the role of custodians in retail marketing material, including product disclosure statements (PDS).

Review of the role of asset consultants conducted

ASIC has announced that it has completed a review of the role of asset consultants in the superannuation and managed investments sector. The review was aimed at increasing ASIC's understanding of this sector by considering compliance by participants with the

conditions of their Australian financial services (AFS) licences, as well as other financial services laws. For the purposes of the review, "asset consultants" were defined as entities which provide financial product and investment advice to wholesale clients in return for some financial benefit.

The review focused on business models, the associated risks and risk management and the role of asset consultants in ensuring compliant behaviour by others in the financial services industry.

ASIC noted there was a growing trend towards bringing the investment management functions in-house and identified conflicts of interest present in the business models of asset consultants which need to be managed appropriately. For example, some models involved fee structures which encouraged the use of services and products of related parties of the asset consultant. ASIC intends to include conflict of interest examples for asset consultants in updates of Regulatory Guide 181 *Managing conflicts of interest* (RG 181) shortly.

ASIC releases guidance on "crowd funding"

On 14 August 2012, ASIC issued guidance to promoters of "crowd funding" to further their understanding of arrangements which may be regulated by ASIC under the Corporations Act and ASIC Act.

"Crowd funding" involves the use of the internet and social media to raise funds in support of a specific project or business idea, with project sponsors or pledgers typically receiving some reward in return for their funds (although in some cases, the reward expected may be of a minor value and is merely incidental rather than the purpose of the contribution).

Depending on the type of "reward" offered by the project creator to those giving funding, ASIC believes crowd funding could involve a managed investment scheme, the provision of financial services requiring an Australian financial services (AFS) licence or fundraising requiring a prospectus. Advertising and publicity restrictions also apply to advertising and publicising an offer of financial products or securities in certain circumstances.

Financial advice

Government announces creation of limited AFS licence for accountants

On 23 June 2012, the Government announced the planned creation of a new limited form of Australian financial services (AFS) licence. The new form of AFS licence does not allow specific product recommendations but is designed to enable accountants (and any financial advisers) who may hold it to provide strategic and low-cost forms of financial advice.

In addition to being able to advise on self-managed superannuation (SMSF) funds and superannuation generally, licence holders will be able to give "class of product advice" on basic deposit products, general and life insurance, securities and simple managed investment schemes.

The Government also announced a streamlined transition period that will be available for accountants between 1 July 2013 and 1 July 2016. These arrangements will make it easier for accountants to transition into the new limited AFS licence regime in recognition of their existing professional qualifications.

ASIC to discuss next phase of financial advisers exam

ASIC has announced the next phase of its consultation with the financial advice industry about its proposal to implement a national examination for financial advisers.

It will soon hold discussions with industry participants about the potential for setting up a self-regulatory organisation which would develop and administer the exam.

ASIC believes a self-regulatory model, when implemented effectively, can be an efficient approach to establishing the exam.

ASIC is proposing a 2014 start date for the exam with a two-year transition period and it would like to see the completion of the national exam as a requirement of membership of an industry association or a condition of employment for industry participants.

Trans-Tasman mutual recognition of financial advisers announced

On 2 July 2012, ASIC and New Zealand's Financial Markets Authority (FMA) announced mutual recognition arrangements for Australian and New Zealand financial advisers.

This will enable financial advisers to provide services in each other's countries based on the qualifications and experience they have attained from their home country.

While the Trans-Tasman mutual recognition legislation already applies to Australian financial services licence holders, most of these licence holders are firms or companies. To enable individual financial advisers with relevant qualifications to operate on either side of the Tasman, both regulators recognised a need for a different

mechanism based on the spirit of that legislation.

FMA has granted an exemption for Australian qualified advisers allowing them to apply to be authorised financial advisers (**AFAs**) in New Zealand based on their existing Australian qualifications.

Australian advisers who hold the specified qualifications will be exempt from the educational qualifications requirements for AFAs set out in the Code of Professional Conduct for AFAs, and will be able to hold a licence relevant to their practice area and qualifications in Australia. The exemption is also subject to a number of other restrictions and conditions, such as compliance with the New Zealand Code of Professional Conduct for AFAs.

To enable New Zealand AFAs to operate in Australia, ASIC has amended its regulatory guides which set out the minimum training requirements for individual financial advisers in Australia. Recognition has been given to New Zealand AFAs and Qualifying Financial Entity advisers to enable them to practise in Australia in certain areas.

Derivatives and CFD providers

New financial requirements for issuers of over-the-counter derivatives

On 31 July 2012, ASIC released new financial requirements for Australian financial services licensees who issue over-the-counter (**OTC**) derivatives to retail clients, including contracts for difference and margin foreign exchange.

Under the new requirements, from 31 January 2013 retail OTC derivatives issuers must meet a net tangible asset (**NTA**) requirement which will require them to hold NTA the greater of $500,000 or 5% of average revenue. This NTA requirement will increase to $1,000,000 or 10% of average revenue from 31 January 2014.

Issuers will also be required to, each quarter, prepare projections of cash flows over at least a 12 month period based on their reasonable estimate of revenues and expenses over that term and these projections must be certified as reasonable by the issuer's directors. In addition, there is also an NTA liquidity requirement, providing that issuers must hold 50% of the required NTA in cash or cash equivalents and 50% in liquid assets, to ensure financial resources can be used effectively to meet unexpected losses and expenses as they arise.

New legislative framework for over-the-counter derivatives

On 25 July 2012, a draft of the *Corporations Legislation Amendment (Derivatives Transactions) Bill 2012* was released. The legislation would amend the Corporations Act by introducing a framework to allow the Minister for Financial Services and Superannuation to decide that mandatory obligations should apply to certain classes of over-the-counter (OTC) derivatives, requiring those classes to be reported, centrally cleared, or traded on suitable trading platforms. This will allow regulations and rules to be made to specify the details of these obligations.

Carbon trading

ASIC releases information sheet for licensing of financial services in emissions units

On 27 June 2012, ASIC released an information sheet to assist those intending to apply for an Australian financial services (**AFS**) licence to provide services in emissions units and related derivatives from 1 July 2012.

Please refer to our article *Need an AFS licence to participate in carbon markets?,* in this quarterly review for more information.

Property funds

ASIC releases review of unlisted property sector

On 17 July 2012, ASIC released the findings of a review of responsible entities (REs) operating managed investment schemes in the unlisted property sector. The review uncovered the following areas of non-compliance:

- non-compliance with key Australian financial services (AFS) licence conditions including net tangible assets (NTA), base level financial requirements, professional indemnity insurance, external dispute resolution scheme membership and key persons;
- inappropriate compliance arrangements for the nature, scale and complexity of the REs business and insufficient resources to undertake the compliance function;
- poor risk management systems/plans;
- insufficient measures to control and monitor the release of information to investors; and
- inadequate controls to manage related party transactions.

Clean Building Managed Investment Trusts (MITs) 10 per cent concessional tax rate

On 27 June 2012, the Government announced that it would introduce a 10 percent final withholding tax rate for managed investment trusts (MITs) that only hold newly constructed energy efficient commercial buildings.

The concession will be available in relation to office buildings that have obtained a 5-star Green Star rating or a predicted 5.5 star NABERS rating, and retail centres and non-residential accommodation that meet equivalent standards. The new regime will apply where construction of the building commences after 1 July 2012.

Legislation update

Tax reform to boost financial services outlook passes Parliament

On 23 August 2012, the *Tax Laws Amendment (Investment Manager Regime) Bill 2012* was passed by Parliament.

The legislation constitutes the first two elements of the Investment Manager Regime (**IMR**) which are designed to:

- address the impact of the application of the US accounting rules — widely referred to as "FIN 48" — on managed funds which invested in or through Australia in the 2010–11 and earlier income years;
- exclude from Australian tax, for 2010–11 and later income years, certain income of widely held foreign funds that is taxable only because the fund uses an Australian based agent, manager or service provider; and
- remove uncertainty as to the tax treatment of "conduit income" of managed funds as recommended by the Henry Review.

Discussion paper on trust reforms released

On 30 July 2012, the Government released a discussion paper inviting stakeholder views on options for a more workable approach for fixed trusts. The discussion paper considers a number of options for reform, including modifying or replacing the existing definition of "fixed trust".

Following feedback from stakeholders during the process, the Government will also be amending the proposed start date for the broader reform of trust income taxation from 1 July 2013 until 1 July 2014.

The Government will release a policy design paper this month which will further develop options for a model for the taxation of trusts. The new tax system for managed investment trusts will now also have a start date of 1 July 2014, to coincide with the general update and rewrite of the trust provisions, and the interim streaming rules for managed investment trusts introduced in 2011 will also be extended for a further two years to 1 July 2014.

Submissions on the discussion paper are due by Friday, 14 September 2012.

For further information, please contact:

Chris Mee
Special Counsel
+61 7 3338 7589
cmee@thomsonslawyers.com.au

Loretta Reynolds
Partner
+61 8 8236 1406
lreynolds@thomsonslawyers.com.au

Eugene Fung
Partner
+61 7 3338 7524
efung@thomsonslawyers.com.au

Michael George
Special Counsel
+61 2 9020 5793
mgeorge@thomsonslawyers.com.au

www.thomsonslawyers.com.au

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