Disclosure requirements for shares and debentures (Part 9)

9.1 Introduction

With the introduction of the Financial Services Reform Act 2001 (FSR Act) in March 2002, the Corporations Act 2001 (the Corporations Act) contains two separate disclosure regimes for financial products:

- Chapter 6D for securities and debentures; and

- Part 7.9 for financial products other than securities (such as managed investment products and superannuation).

These regimes were designed to effectively promote disclosure across all financial products, while taking into account the inherent differences between securities and other financial products. These differences are reflected in the different levels of disclosure in each regime - a due diligence and general disclosure test applied to securities in Chapter 6D's prospectus and a directed disclosure regime applied to other financial products in Part 7.9's Product Disclosure Statement.

While the FSR Act harmonised the disclosure arrangements that applied across a range of financial products, they were not extended to shares and debentures. The principle reason was that the Corporate Law Economic Reform Program Act 1999 (CLERP Act 1999) had only recently amended the requirements in Chapter 6D for securities.

The recent reforms have been subject to extensive consultation and have put in place two effective disclosure regimes for all financial products. Nevertheless, there is the potential to improve the operation of the respective disclosure regimes. Potential harmonisation and other general improvements may lead to more effectively targeted disclosure regimes.

9.2 The disclosure regimes

9.2.1 Chapter 6D

Chapter 6D was introduced as part of a suite of reforms contained in the CLERP Act 1999 and commenced operation in March 2000. The reforms were designed to minimise the costs of fundraising while improving investor protection.

Chapter 6D utilises a general disclosure test, which places the onus on the preparers of a prospectus to provide the information reasonably required by investors and their advisers in deciding whether to subscribe for securities. There has been very strong support from the business community for the general disclosure test regarding securities, with an acknowledgment that the quality of information available to the marketplace has improved since its introduction.

9.2.2 Part 7.9

Part 7.9 was introduced as part of the FSR Act and came into effect in March 2002. For existing industry participants, there is a two-year transition period until the regime fully comes into force in March 2004.

Part 7.9 takes a directed approach to disclosure, rather than the general disclosure approach in Chapter 6D. The directed disclosure approach is supplemented by a requirement to provide other information known to the issuer that might materially influence an investor's decision to acquire a financial product. The focus is on the needs of retail investors, rather than professional advisers and the aim is to achieve shorter, more comparable disclosure documents.

Public submissions during the development of the FSR Act were supportive of harmonised and consistent disclosure obligations. Many noted the need to develop flexible obligations, which could apply to a range of financial products, and that it would be undesirable to introduce prospectus type requirements to products that do not warrant that level of disclosure.

9.3 Better targeting the disclosure regimes

9.3.1 Consistency in presentation

The FSR Act introduced a requirement for Product Disclosure Statements in section 1013C(2) to be worded and presented in a clear, concise and effective manner. This requirement does not exist in Chapter 6D. The application of such standards for prospectuses in Chapter 6D would improve the effectiveness of these documents.

The Government is mindful that this change may impact upon other provisions. A specific example is where a bidder offers securities under a takeover bid. Under section 636, the bidder's statement must include all material that would be required for a prospectus for an offer of the securities. The current takeover disclosure requirements were designed to be consistent with the CLERP Act 1999 fundraising disclosure requirements (see Explanatory Memorandum CLERP Act 1999 paragraph 7.23.)

Proposal 29 - Improve the presentation of prospectuses

The Government will improve the effectiveness of disclosure in prospectuses through extending the requirement for 'clear, concise and effective wording and presentation' in Chapter 7 for product disclosure statements to Chapter 6D for prospectuses.

9.3.2 'Sophisticated investor' and 'wholesale client'

Harmonisation is proposed between Chapter 6D's 'sophisticated investor' and Part 7.9's 'wholesale client'. Even though both Chapter 6D and Part 7.9 do not require disclosure documents to be provided to a class of investors, which broadly represent the same class of persons, the definitions adopted to achieve this result differ somewhat. As each approach has a similar objective and produces a similar result, there is scope for harmonisation of the terms to classify those investors who do not require the protection of the disclosure regimes. This will improve the consistency and effectiveness of disclosure overall.

Chapter 6D - Sophisticated investor

The Corporations Act requires that an offer of securities or debentures needs prospectus disclosure to investors unless excluded in section 708. Along with exclusions for small offerings, subsections 708(8) to 708(20) of the Corporations Act identify certain persons and circumstances as not requiring disclosure, including the following persons:

- a 'sophisticated investor;' which is defined where:
  the minimum amount payable for securities is at least $500,000; or
  the collective amount invested in the same class of securities adds up to $500,000; or
  a qualified accountant certifies the net asset worth of $2.5 million or gross income for each of the last two financial years of at least $250,000 per annum.
- the offer is made to a person through a financial services licensee where the licensee is satisfied that the person has relevant previous experience in investing in securities; and
- a 'professional investor,' as defined in section 9 of the Corporations Act.

The exemption for 'sophisticated investors' recognises that certain investors are able to protect their own investment interests without regulatory protection. In fact, both industry and such investors may discourage regulatory coverage and consider the imposition of any legislative disclosure to be an unwanted cost and burden.

Part 7.9 - Wholesale client

The FSR Act also draws a distinction (for financial products other than securities and debentures) between 'retail' and 'wholesale' clients. Wholesale clients in Part 7.9 do not receive the same level of protection, as these clients are better informed and better able to assess the risks involved.

Wholesale clients are defined in the negative, that is, as persons who are not retail clients. With the exception of general insurance products, superannuation and RSA products, a financial product and the related disclosure requirements is provided to what is defined as a retail client unless the provisions of section 761G(7) apply:

- the price or value for the provision of the financial product is at least $500,000; or
- the financial product or service is provided for use in connection with a business that is not a small business; or
- when not provided for use in connection with a business, a qualified accountant certifies the net asset worth of $2.5 million or gross income for each of the last two financial years of at least $250,000 per annum; or
- the person is a 'professional investor,' as defined in section 9 of the Corporations Act.

Current overlap

To some extent elements of the section 761G definition of retail and wholesale clients are essentially a duplication of the exclusions from disclosure under section 708. The two regimes already share several tests in common in identifying those investors that do not require disclosure:

- the product value test and currently prescribed amounts;
- the individual wealth test and currently prescribed amounts; and

- the professional investor test.
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Differences between sophisticated investor and wholesale client

There are significant differences between the two regimes, with each containing separate tests that reflect the different nature of shares and other financial products. Specific examples of the differences include:

- Chapter 6D's certification of investment experience was not replicated in Part 7.9. Further, a mechanism canvassed during the development of the FSR Act that would have effectively allowed people to 'opt-out' from the disclosure regime was not well supported and was not adopted.
- Chapter 7's business test is not found in Chapter 6D.
- While the individual wealth test is shared between the two regimes, section 761G's wealth test is subject to 'the relevant service or product is not provided for use in a business,' while section 708 does not contain this limitation.
- The structure of the regimes is also not consistent. Chapter 6D provides for disclosure to all purchasers of securities, except in limited circumstances in section 708. Part 7.9 relies on the retail client or wholesale client distinction, with all retail clients receiving full disclosure and wholesale clients, defined as those who are not retail clients, not receiving this information.

It is desirable to achieve greater harmonisation to provide a more consistent approach for determining which investors will receive disclosure information and which will not. This will promote consistency of regulation where possible across all financial products.

Proposal 30 - Harmonisation of when disclosure is not required

The Government will more closely align the exemptions from the disclosure regimes that apply to sophisticated investors and wholesale clients.

9.3.3 Certification of investment experience

The current operation of the certification ability regarding securities under section 708 has been the subject of concerns related to liability. There is no similar provision in Part 7.9. Industry participants have suggested that they may be held liable in the event that something goes wrong with investments made by a person they have certified as sufficiently experienced in securities investment to not need a disclosure document.

This potential liability might be viewed as an incentive for licensees to ensure that persons do in fact possess the requisite experience to justify such a certification. However, it might also raise doubts about whether this may unduly limit, in practice, the use of the provisions.

The decision as to whether to certify a person's investment experience appears at present to be a commercial decision which must be balanced against the associated liability risk. A form of sanction for misuse is necessary, as these provisions may provide an avenue for parties to subvert the intent of the disclosure requirements. This sanction is currently potential civil liability.

The Government believes that the current arrangements provide an appropriate balance between these factors. The Government will retain the current option for licensees to certify investment experience in Chapter 6D based on the existing potential for liability.

9.3.4 Placements
Secondary sales occur when a security or financial product is issued to an intermediary who then on-sells them to the wider market.

The FSR Act tightened disclosure obligations related to secondary sales of securities and financial products by amending the operation of section 707 of the Corporations Act to remove some unintended potential loopholes in the CLERP Act 1999. It also inserted section 1012C of the Corporations Act, which applies to financial products other than securities.

The Government has been clear in its intent to enhance consumer protection through minimising the avoidance of disclosure requirements.

Industry concerns
Industry has raised concerns about a potentially adverse impact of the need to satisfy more stringent disclosure arrangements. In particular, some have argued that the operation of the amended provisions may cause practical difficulties for the placements market for securities.

Further, concerns have been raised that the amended anti-avoidance provisions will impact upon underwriting arrangements, because an underwriter will generally have intended to on-sell any securities it is required to take up as a result of a shortfall in acceptances of an offer. Where an underwriting arrangement is subject to these disclosure obligations, additional costs may be imposed. Underwriters may choose to recoup these costs though the imposition of higher costs for customers or through seeking a greater discount on the underwritten share price. Ultimately, higher costs may adversely impact upon the efficiency of the secondary sales market.

It has also been suggested that retail clients who were issued financial products, without disclosure under a specific statutory or regulatory exemption from the disclosure provisions, might not be able to on-sell those products within 12 months of their issue.

Following the commencement of the FSR Act, the Australian Securities and Investments Commission (ASIC) has sought to clarify the operation of these provisions by class order relief and the release of consultation papers seeking industry's views on this issue. Currently, interim class order relief addresses a number of concerns related to existing ASIC prospectus relief exemptions or statutory exemptions, and where there is adequate information already available to the market.

The Government proposes to reduce the potential for the anti-avoidance provisions to interfere with legitimate business practices by imposing additional costs, while

maintaining investors ability to make informed investment decisions. In some circumstances, imposing additional disclosure obligations (with associated costs) on the provider of the security or financial product may be of little or no benefit in terms of consumer protection or market integrity.

The Government will improve the practical operation of the anti-avoidance provisions on placements to limit the need for disclosure where information is already available.

Proposal 31 - Improve the operation of the placement provisions

The Government proposes that the disclosure requirements for secondary sales reflect the principle that where a person:

- already holds pertinent information, or
- has access to comparable information to what they would have otherwise received in a reasonable, timely and cost-effective manner, no further disclosure obligations should apply.

This will provide a sounder legislative basis for the operation of placements and will also facilitate ASIC taking relief action where appropriate.

Relationship with continuous disclosure

It has been suggested that as a general principle, placements of any listed securities should not require a prospectus where a company is listed on the Australian Stock Exchange (ASX) and has been continuously quoted for 12 months. This is on the basis that the price at which those sales take place should have factored into it all information disclosed by way of periodic reports and the continuous disclosure obligations in the ASX Listing Rules which are legislatively supported by Chapter 6CA of the Corporations Act.

However, information available under the continuous disclosure regime is not necessarily the same as that available under a prospectus, especially noting the operation of the carve-out included under ASX Listing Rule 3.1. Hence, the secondary market may not have access to the information necessary to allow retail investors to make a fully informed decision when entering into a secondary transaction resulting from a placement. This view is evidenced by instances where professional investors offered securities in a placement may obtain warranties as to any information withheld under the carve-out.

These factors suggest that the current general requirement for a prospectus is appropriate. Consequently, it is not the Government's intention to exclude secondary sales of listed securities from the existing prospectus disclosure obligation solely on the basis of the continuous disclosure requirements.

The Australian Government….the Treasury
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