ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 33

Disclosure for on-sale of securities and other financial products

June 2002

What this discussion paper is about

1 This discussion paper sets out our proposals for ongoing relief from the disclosure requirements under the *Corporations Act 2001* ("Corporations Act") for the on-sale of:

(a) securities (see s707(3) and (4)); and

(b) other financial products (see s1012C(6) and (7)).

2 We have provided interim relief from these requirements ("the on-sale provisions") for securities issued without disclosure in the 9 months after 11 March 2002: see our Class Order [CO 02/0272] as amended by Class Orders [CO 02/0334] and [CO 02/0716].

Note: Class Order [CO 02/0716] extended the relief for a further 3 months from 11 September 2002 to 11 December 2002.

3 We consider that relief from the on-sale provisions could be given in certain circumstances without defeating their legislative purpose and the level of investor protection they provide to retail clients. Broadly, our proposed relief falls into two categories:

(a) relief to facilitate cost-effective fundraising in wholesale markets where the interests of retail clients are not adversely affected. This is where retail clients have, through some alternative means, the benefit of disclosure comparable to that which might otherwise have been contained in a disclosure document or Product Disclosure Statement ("PDS") ("disclosure-based relief", see **Section 2**); and

(b) relief to ensure that products issued to persons including retail clients under separate disclosure exemptions may be readily on-sold ("exemption-based relief", see **Section 3**).

4 We have set out our proposals for relief from the on-sale provisions in this discussion paper instead of issuing a policy proposal paper ("PPP"). This is because we also canvass the desirability of law reform as an approach to dealing with the issues (see our questions in Q2.6, Q2.12, Q2.18 and Q3.4).

5 We are happy to consider any further issues and proposals you may wish to raise. However, where issues or proposals involve regulatory policy, we will consider them against the regulatory objectives of the legislation (see **Section 1**), that is, the need to:

(a) uphold the anti-avoidance purpose of the on-sale provisions; and

(b) promote retail client protection and market integrity.

Note: For example, we do not think that a difficulty in identifying which particular securities are affected by the on-sale provisions (because all securities in a particular quoted class are fungible) provides a justifiable ground for relief from these provisions.

6 The policy proposals set out in this discussion paper are not final policy. They also do not indicate that we will provide any particular relief.

7 This paper does *not* deal with direct or indirect off-market secondary sales of financial products by controllers regulated under s707(2) and (5) and s1012C(5) and (8) of the Corporations Act.

Your feedback is invited

8 We are seeking your feedback on the questions we raise in this discussion paper by 8 August 2002.

Your comments

Comments are due by 8 August 2002 and should be sent to:

Dhammika Amukotuwa, Regulatory Policy Branch
Australian Securities & Investments Commission
GPO Box 5719AA
Melbourne VIC 3000

email: On-Sales.Disclosure@asic.gov.au

Contact Dhammika Amukotuwa on 03 9280 3395 for more information about this discussion paper.

Contents

Section 1: Legislative context

1.1 The *Financial Services Reform Act 2001* ("FSR Act") largely came into effect on 11 March 2002. Among other things, it amended the provisions that regulate the on-sale of financial products within 12 months of their issue, specifically:

(a) securities (under s707(3) and (4)); and

(b) "non-securities" (ie other financial products) (under s1012C(6) and (7)).

Note: See Appendix A for the text of these provisions. Securities in this context include shares and debentures, and legal or equitable rights or interests relating to a share or debenture. Other financial products include managed investment products, and legal and equitable interests relating to such products.

1.2 The on-sale provisions are designed to address some of the problems associated with the operation of s707(3) and 707(4) of the Corporations Act as in force before 11 March 2002 ("the old on-sale provisions").

1.3 These provisions, like their predecessors (such as the former s1030 and 1030(1A) of the Corporations Law), are "anti-avoidance" provisions. They are designed to minimise the opportunity for issuers of securities to avoid preparing prospectuses by first issuing the securities to an intermediary who then on-sells them into the wider market. These provisions seek to ensure that, regardless of whether securities are issued directly to retail clients or indirectly:

(a) retail clients receive adequate disclosure for what is in substance an issue of securities; and

(b) the issuer is liable to retail clients for the efficacy of that disclosure.

Note: The way the old on-sale provisions were intended to operate over securities was set out in the Explanatory Memorandum to the *Corporate Law Economic Reform Program Bill 2000* (CLERP Bill) and was also highlighted in the Parliamentary Joint Committee Report on CLERP Bill issued in May 1999.

1.4 Although the old on-sale provisions were intended to improve on the former s1030 and 1030(1A) of the Corporations Law, there were nonetheless some apparent weaknesses in their anti-avoidance effect. For example, under these provisions:

(a) the on-sale of securities issued without disclosure only required disclosure if sold within 12 months of the issue where the person who *issued* the securities had a purpose of on-sale. If the person to whom the securities were issued

without disclosure ("the acquirer") had an independent purpose of on-sale, that person could on-sell to retail clients without disclosure within 12 months of the issue;

(b) it was not clear whether the purpose of on-sale needed to be the sole or dominant purpose of the issuer, or just one of several purposes; and

(c) it was difficult to establish the subjective purpose of the issuer.

1.5 Some apparent anomalies derived from these weaknesses. For example, one issuer obtained quotation of a new class of securities and then issued large parcels of the securities of the same class to intermediaries, who almost immediately on-sold the securities into the wider market. The issuer argued that, as its purpose was mainly to raise funds and it did not care if the products were on-sold, the old on-sale provisions did not apply. For the reasons noted above, ASIC could not take enforcement action.

1.6 For on-sale of debentures issued without prospectus disclosure, the adverse impact on retail clients was exacerbated. In such cases, investor protection available to retail clients through the debenture trustee and trust deed requirements under Chapter 2L of the Corporations Act did not apply.

Note: Under both the Corporations Act and the old Corporations Law, debentures issued where prospectus disclosure is not required do not attract the debenture trustee and trust deed requirements under Chapter 2L.

1.7 FSR Act amendments addressed issues under the old on-sale provisions by requiring disclosure under Parts 6D.2 or 7.9 for the on-sale of a financial product where:

(a) the product was issued without disclosure;

(b) there are reasonable grounds for concluding that the purpose of the issuer *or* the purpose of the acquirer included a purpose of on-sale of the product; and

(c) the product is sold within 12 months after the date of issue to a retail client other than under a specific exception.

1.8 Shortly before the current on-sale provisions commenced, arguments were put to ASIC that their operation would cause practical difficulties for activities that were up to then regarded as unexceptional. These difficulties particularly related to provisions requiring a disclosure document for the on-sale of securities into the retail market merely because of an intention of the initial acquirer to on-sell.

1.9 Feared adverse consequences included that:

(a) ordinary placements of equities might be unduly impeded; and

(b) retail clients who were issued financial products without disclosure under a specific exemption from the disclosure provisions (eg for dividend reinvestment plans or as consideration for a takeover offer) might not be able to on-sell those products within 12 months of their issue.

1.10 We granted interim class order relief for securities issued in the 6 months from 11 March 2002 (see our Class Order [CO 02/0272]) to address some of these issues while a longer-term response could be considered. In developing the proposals in this paper, we have taken into account how the interim relief has operated to date.

1.11 We have also extended the interim class order relief by a further 3 months from 11 September 2002 to 11 December 2002 (see our Class Order [CO 02/0716]) to:

(a) allow for further public debate on the proposals including any further industry proposals made in the submissions; and

(b) provide flexibility to allow industry to adjust to any new requirements under the new policy.

1.12 A Regulatory Impact Statement will be prepared at the time of developing ASIC's final policy relating to relief following public consultation on the proposals in this paper.

Section 2: Disclosure-based relief

2.1 This section sets out our proposals for disclosure-based relief from the on-sale provisions. It includes a discussion of the background and rationale for the proposals, and questions for your feedback:

(a) Proposal 1: Shares – disclosure of previously withheld information;

(b) Proposal 2: Shares – contemporaneous or subsequent prospectus;

(c) Proposal 3: Debentures – disclosure of previously withheld information;

(d) Proposal 4: Debentures – contemporaneous or subsequent prospectus;

(e) Proposal 5: Managed investment products – disclosure of previously withheld information; and

(f) Proposal 6: Managed investment products – contemporaneous or subsequent PDS.

Background

2.2 The issue of financial products to wholesale investors is an important feature of the Australian capital market. Generally, such issues can be completed more quickly and at a lower cost than issues made to retail clients due to a combination of factors, including economies of scale and fewer regulatory requirements.

2.3 Many of the products issued in the wholesale market are of the same kind as those issued or traded in the wider markets. In such cases, financial products issued to wholesale investors could be on-sold to retail clients. Such transactions, being secondary in nature, usually do not attract an obligation to issue a disclosure document. This is because disclosure requirements in the Corporations Act (eg prospectus disclosure under Part 6D.2 and PDS disclosure under Part 7.9) generally apply to the issue of financial products and not to their on-sale, unless the sale occurs within 12 months of the issue and the on-sale provisions apply.

2.4 Financial products issued in the wholesale market are likely to be on-sold into the wider market in the ordinary course of wholesale investors carrying on their investment activities. In such transactions, avoiding disclosure to retail clients will usually not be a relevant motive.

2.5 However, the differences in the regulatory requirements between wholesale and retail markets necessarily raises the potential for:

(a) financial products issued in the wholesale market to reach the retail market within 12 months of their issue. This may undermine the requirements for disclosure for retail offers of financial products; and

(b) opportunities for abuse of those differences by persons who are inclined to exploit them.

2.6 As noted in Section 1, anti-avoidance provisions have long been a feature of Australian law. The need for such provisions is also recognised in overseas jurisdictions. In the United States securities issued into the wholesale market under one of the exceptions from their disclosure rules must generally remain in the wholesale market for 1 year (that is, for 12 months after issue they can only be on-sold to other wholesale investors). In Canada the securities are generally confined to professional markets for a period of 4 - 12 months, depending on the type of security and the type of issuer. The provisions in North America apply without regard to the purpose of a party to the transaction in which they were issued. As such, the North American provisions are considerably stricter than the requirements in the on-sale provisions under Australian law.

2.7 By enacting the current on-sale provisions Parliament intended to tighten the operation of their anti-avoidance effect. In considering relief, it would generally not be appropriate for ASIC to exercise its discretionary powers to make fundamental changes to the settings determined by the Parliament. This is particularly the case for recently-enacted legislation.

2.8 However, ASIC can exercise its powers to enable the legislation to operate more appropriately in particular circumstances that may not have been envisaged, or to ameliorate apparently unintended outcomes. More fundamental changes to the legislative settings are matters for the Parliament.

2.9 Given this background, ASIC needs to balance the commercial considerations relevant to wholesale capital markets against the retail client protection intended by disclosure under the on-sale provisions. We believe that any significant relief from the on-sale provisions can only be justified if a comparable level of protection is otherwise available to retail clients who acquire financial products by way of transfer within 12 months of their issue. We seek to achieve this balance through our proposals.

Proposal 1: Shares – disclosure of previously withheld information

2.10 We propose that relief should be provided from the on-sale provisions for the on-sale of securities where all the following requirements are met:

(a) the securities are in a class of quoted ED securities at all times in the 12 months before the issue date;

(b) the issuer is listed on an ASX-operated financial market;

(c) the securities are not debentures;

(d) the securities were issued under a completed contract of sale (ie full consideration for the issue has been paid);

(e) there was no determination under s713(6) in force against the issuer at the time of the issue of the securities;

(f) the issuer provides a notice to ASX either:

(i) setting out all information of the kind that would be required under s713(5) if a transaction-specific prospectus were to be issued relating to the offer; or

(ii) stating that there is no information of that kind to be disclosed; and

(g) the notice under sub paragraph (f) is provided to ASX at the time of the issue or within 2 business days after the issue, but before any on-sale of the securities that would otherwise require disclosure.

Proposal 2: Shares – contemporaneous or subsequent prospectus

2.11 We propose that relief should be provided from the on-sale provisions for the on-sale of securities where all the following requirements are met:

(a) the securities are in a class of quoted ED securities of a body listed on an ASX-operated financial market at the time of the on-sale;

(b) the securities are not debentures;

(c) the securities were issued under a completed contract of sale (ie full consideration for the issue has been paid);

(d) there was no determination under s713(6) in force against the issuer at the time of the issue of the securities; and

(e) there is a prospectus under Part 6D.2:

(i) relating to securities of the same class; and

(ii) issued at or after the time of the issue of the securities, but before any on-sale of the securities that would otherwise require disclosure.

Proposal 3: Debentures – disclosure of previously withheld information

2.12 We propose that relief should be provided from the on-sale provisions for the on-sale of debentures where all the following requirements are met:

(a) the debentures are in a class of debentures that were ED securities at all times in the 12 months before the issue date;

(b) the issuer is listed on an ASX-operated financial market;

(c) the debentures were issued under a completed contract of sale (ie full consideration for the issue has been paid);

(d) the debentures are covered by a trust deed under Chapter 2L;

(e) there was no determination under s713(6) in force against the issuer at the time of the issue of the debentures;

(f) the issuer provides a notice to ASX:

(i) setting out all information of the kind that would be required under s713(5) if a transaction-specific prospectus were to be issued relating to the offer; or

(ii) stating that there is no information of that kind to be disclosed; and

(g) the notice under sub paragraph (f) is provided to ASX at the time of the issue or within 2 business days after the issue of the debentures, but before any on-sale of the debentures that would otherwise require disclosure.

Proposal 4: Debentures – contemporaneous or subsequent prospectus

2.13 We propose that relief should be provided from the on-sale provisions for the on-sale of debentures where all the following requirements are met:

(a) the debentures are in a class of debentures that are ED securities of a body listed on an ASX-operated financial market at the time of the on-sale;

(b) the debentures were issued under a completed contract of sale (ie full consideration for the issue has been paid);

(c) the debentures are covered by a trust deed under Chapter 2L;

(d) there was no determination under s713(6) in force against the issuer at the time of the issue of the debentures; and

(e) there is a prospectus under Part 6D.2:

(i) relating to debentures of the same class; and

(ii) issued at or after the time of the issue of the debentures, but before any on-sale of the debentures that would otherwise require disclosure.

Proposal 5: Managed investment products – disclosure of previously withheld information

2.14 We propose that relief should be provided from the on-sale provisions for the on-sale of managed investment products where all the following requirements are met:

(a) the products were ED securities at all times in the 12 months before the issue date;

(b) the scheme is listed on an ASX-operated financial market;

(c) the products were issued under a completed contract of sale (ie full consideration for the issue has been paid);

(d) the responsible entity has not been notified by ASIC that it may not rely on this relief because the entity has in the previous 12 months breached any of the following provisions in respect of the scheme: Chapter 2M, s674(2), s675(2), s1016E or s1021E;

(e) the issuer provides a notice to ASX:

(i) setting out all information of the kind that the issuer is not required to include in a continuous disclosure notice provided to ASX because of ASX Listing Rule 3.1 that would otherwise have been required to be disclosed in a PDS for an offer of the products; or

(ii) stating that there is no information of that kind to be disclosed; and

(f) the notice under sub paragraph (e) is provided to ASX at the time of the issue or within 2 business days after the issue of the products, but before any on-sale of the products that would otherwise require disclosure.

Proposal 6: Managed investment products – contemporaneous or subsequent PDS

2.15 We propose that relief should be provided from the on-sale provisions for the on-sale of managed investment products where all the following requirements are met:

(a) the products are in a class of quoted ED securities of a scheme listed on an ASX-operated financial market at the time of the on-sale;

(b) the products were issued under a completed contract of sale (ie full consideration for the issue has been paid);

(c) the responsible entity has not been notified by ASIC that it may not rely on this relief because the entity has in the previous 12 months breached any of the specified provisions in respect of the scheme (that is, Chapter 2M, s674(2), 675(2), 1016E or 1021E); and

(d) there is a PDS under Part 7.9:

(i) relating to the same kind of managed investment products as the products that were issued without disclosure; and

(ii) issued at or after the issue of the managed investment products, but before any on-sale of the products that would otherwise require disclosure.

Rationale

Shares: Proposals 1 and 2

2.16 As noted earlier, the purpose of the on-sale provisions is to ensure adequate disclosure to retail clients acquiring financial products as a result of on-sales that are, in effect, indirect issues of those products. We consider that this purpose is not undermined where retail clients have the benefit of broadly equivalent disclosure through alternative means, resulting in a comparable degree of overall protection.

2.17 In this regard, some comfort can generally be derived from on-sales taking place based on market prices determined by a financial market operated by Australian Stock Exchange Ltd (ASX). The price at which those sales take place should have factored into it all the information that has been disclosed about the entity whether by way of periodic reports or under the continuous disclosure obligations in ASX Listing Rules supported by Chapter 6CA of the Corporations Act.

2.18 However, the information that is available to the market as a result of these provisions is not necessarily all that would be elicited through a

prospectus. This is largely because issuers are not required to include in their continuous disclosure notices provided to ASX certain commercially sensitive information under express exclusions set out in Listing Rule 3.1 ("confidentiality carve-out").

2.19 We consider that this information should be disclosed before any securities issued without a disclosure document are sold into the wider market. Proposal 1 involves disclosure by way of notice to ASX that either sets out the information, or indicates that there is no relevant information. Listed companies with proper systems in place to comply with the Listing Rules should be aware of the information they have withheld from the market based on the confidentiality carve-out.

2.20 Moreover, while our proposal is aimed at informing the secondary market, we understand that where professional investors are offered securities in a placement, they commonly obtain warranties as to whether any information is being withheld under the confidentiality carve-out. In these circumstances, providing the information to ASX should not generally create a new burden. Equally, it is not appropriate for issuers who are not in a position to disclose this information to engage in capital raising.

> Note: Providing an information notice to ASX has been one of the forms of relief most commonly relied upon under our interim Class Order [CO 02/0272].

2.21 Proposal 1 also involves the securities in question having been quoted for a period of 12 months. This requirement is aimed at ensuring that the market has had reasonable experience in pricing the securities. It is consistent with the requirements underpinning the use of transaction specific prospectuses under s713.

2.22 As an alternative, Proposal 2 facilitates the on-sale of securities where there is a contemporaneous or subsequent prospectus for securities of the same class. This may be a full prospectus or a transaction-specific prospectus. Such prospectuses are required to include information of the kind that could otherwise be withheld under the confidentiality carve-out. Market prices for the same class of securities could be expected to have factored into them the information in the prospectus.

2.23 Proposal 2 does not involve a requirement for the securities of the same class to have been continuously quoted for 12 months. This outcome is consistent with securities issued under a prospectus being generally freely tradeable. Moreover, the preparation of a prospectus generally involves rigorous due diligence processes to identify relevant information, providing an additional degree of protection that generally will not be present under Proposal 1.

2.24 We expect that Proposal 2 may be particularly relevant for the resale of securities issued to underwriters of offers made under a

prospectus. We understand that when underwriters take up any shortfall, they do not necessarily do so under the prospectus but may do so under a separate contract. Also, Proposal 2 may be relevant to the on-sale of securities placed with institutional investors in advance of a wider offer under a prospectus.

2.25 Our proposals do not require any specific information to be provided directly to retail clients to whom securities are on-sold. We expect that on-sales would usually take place based on market prices determined on a financial market operated by ASX. Practical considerations aside, we consider that the direct provision of information is not necessary in this case where the securities are quoted and there is an externally determined price-setting process which takes into account disclosures that have been made to the market as a whole.

2.26 In making these proposals, we have also taken into account the prohibitions against misleading and deceptive conduct in the Corporations Act and the ASIC Act 2001. These prohibitions, which carry civil liability, will apply to the conduct of issuers in connection with an issue of financial products including any announcements they make to the market in connection with such an issue. We note that the prohibitions may extend to misleading conduct by omissions (see *GPG (Australia Trading) Pty Ltd v GIO Australia Holdings Ltd (2001) 40 ACSR 252*). While this is not necessarily equivalent to the liability that would be assumed by an issuer for the content of a prospectus, we consider in all the circumstances that there is an adequate degree of protection for retail clients.

2.27 Both Proposals 1 and 2 involve the securities having been issued under a completed contract. This is because outstanding consideration may be an indicator of the securities having been issued for the purpose of on-sale, ie in circumstances where the remainder of the consideration is provided after the securities have been on-sold.

2.28 Another possibility for relief based on an adequately informed market is the inclusion of the issuer within some well-recognised index such as ASX/S&P 200 Index (as under the current ASIC interim relief: Category 4). The inclusion of a stock in some indices may have the effect of increasing analysts' interest in the stock, and in turn may result in more research being available in that stock. Also, such inclusion may entail a certain level of liquidity in the security that arguably allows greater confidence in the price-setting process.

2.29 However, such considerations cannot be regarded as being a substitute for the issuer having kept the market fully informed, including by disclosure of any information withheld under a confidentiality carve-out. Moreover, there would be a regulatory inconsistency if some companies were to be provided with on-going relief on the basis of

having made specific disclosures (including disclosure of information that has been withheld under a confidentiality carve-out), while equivalent relief was provided to other companies that had not.

Your feedback: Proposals 1 and 2

Q2.1 Do you agree that relief along the lines of Proposals 1 and 2 above is justified, on the basis of adequate alternative disclosure? If not, why not?

Q2.2 Would it be preferable if Proposal 1 required the notice to ASX to include all the information that would have to be included in a transaction-specific prospectus for an offer of the securities? If so, why?

Q2.3 Would it be preferable if the information provided to ASX under Proposal 1 or the contemporaneous or subsequent prospectus under Proposal 2 was also required to be displayed on a website, or made available to retail clients through other means free of charge? If so, why?

Q2.4 Are there other grounds on which similar relief should be granted? If so, what are those grounds and why should such relief be provided?

Q2.5 Would it be preferable for relief of the kind set out in Proposals 1 and 2 to be effected by regulations or law reform? If so, why?

Debentures: Proposals 3 and 4

2.30 The rationale for Proposals 3 and 4 is essentially the same as that for Proposals 1 and 2, except insofar as specific provision is made to ensure the continued application of the investor protection provided to retail clients by Chapter 2L.

2.31 Debenture issues that do not require the protection provided by prospectus disclosure under Chapter 6D also do not attract the investor protection provided by the debenture trustee and trust deed requirements under Chapter 2L. If debentures issued without disclosure are on-sold to retail clients, those investors will not usually have the additional protection of a debenture trustee or trust deed. We view the debenture trustee and trust deed requirements as fundamental protections for retail clients.

Your feedback: Proposals 3 and 4

Q2.7 Do you agree that relief along the lines of Proposals 3 and 4 above is justified, on the basis of adequate alternative disclosure coupled with Chapter 2L protection? If not, why not?

Q2.8 Would it be preferable if Proposal 3 required the notice to ASX to include all the information that would have to be included in a transaction-specific prospectus for an offer of the securities? If so, why?

Q2.9 Would it be preferable if the information provided to ASX under Proposal 3 or the contemporaneous or subsequent prospectus under Proposal 4 was also required to be displayed on a website, or made available to retail clients through other means free of charge? If so, why?

Q2.10 Are there other grounds on which similar relief should be granted? If so, what are those grounds and why should such relief be provided?

Q2.11 Would it be preferable for relief of the kind set out in Proposals 3 and 4 to be effected by regulations or law reform? If so, why?

Managed investment products: Proposals 5 and 6

2.32 The rationale for Proposals 5 and 6 is also essentially the same as that for Proposals 1 and 2. However, we have varied these proposals to take into account the disclosure regime that applies to managed investment products (that is, PDS disclosure under Part 7.9 rather than prospectus disclosure under Chapter 6D).

> Note: Our interim relief currently applies to securities. Once the changes made by the FSR Act apply to managed investment products (either they are in a new class issued after commencement of the FSR Act or, for existing products – by opting in or the expiry of the 2-year transitional period), these products will no longer be securities governed by the disclosure regime in Chapter 6D. Instead, they will be governed by the disclosure regime in Part 7.9.

2.33 Most notably, Part 7.9 has no equivalent for s713. Our proposals involve measures that are, as nearly as practicable, equivalent to:

(a) determinations under s713(6) precluding an entity from using transaction-specific prospectuses; and

(b) the disclosure obligation in s713(5) for information withheld under the confidentiality carve-out.

Your feedback: Proposals 5 and 6

Q2.13 Do you agree that relief along the lines of Proposals 5 and 6 above is justified, on the basis of adequate alternative disclosure? If not, why not?

Q2.14 Would it be preferable if Proposal 5 required the notice to ASX to include all the information that would have to be included in a PDS for an offer of the managed investment products? If so, why?

Q2.15 Would it be preferable if the information provided to ASX under Proposal 5 or the contemporaneous or subsequent PDS under Proposal 6 was also required to be displayed on a website, or made available to retail clients through other means free of charge? If so, why?

Q2.16 Are there other grounds on which similar relief should be granted? If so, what are those grounds and why should such relief be provided?

Q2.17 Would it be preferable for relief of the kind set out in Proposals 5 and 6 to be effected by regulations or law reform? If so, why?

Other issues

2.34 We would appreciate your further comments on a number of other general issues relating to possible relief.

Your feedback: Other issues

Q2.19 Have you been required to provide disclosure as a result of the current on-sale provisions or the old on-sale provisions?

Q2.20 Are there additional costs of disclosure under the current on-sale provisions? If so, what are they?

Q2.21 Could you quantify the difference, if any, between the cost of underwriting a placement before and after the commencement of the current on-sale provisions?

Q2.22 What is the anticipated impact on issuers and retail clients if relief of the kind set out in Proposals 1 – 6 were to be implemented?

Q2.23 Are there other issues or considerations we should take into account? If so, what are they and why should we take them into account?

Section 3: Exemption-based relief

3.1 This section sets out our proposal for exemption-based relief from the on-sale provisions. It includes a discussion of the background and rationale for the proposal, and questions for your feedback.

Background

3.2 As discussed in Sections 1 and 2, the on-sale provisions are an anti-avoidance mechanism to prevent indirect issues of financial products to retail clients. However, they may apply to all financial products that are issued directly to retail clients without disclosure. Examples are financial products that are issued under:

(a) the statutory exemptions available for dividend reinvestment or bonus share plans and

(b) ASIC relief for employee share plans and share purchase plans.

3.3 Retail clients who acquire financial products under these exemptions may have a purpose of on-selling. In this case, the on-sale provisions may apply to any on-sale by these clients within 12 months after the issue. Unless they sell under a disclosure exemption, these clients will not be able to on-sell their investments within 12 month of the issue without disclosure.

3.4 We consider that the anti-avoidance objective of the on-sale provisions is to prevent issuers targeting retail clients indirectly without disclosure, rather than to impose disclosure obligations on all retail clients who on-sell within 12 months any financial products they have acquired without disclosure.

3.5 For example, some of the statutory disclosure exemptions available for offers of financial products for issue in schemes of arrangement and takeover bids can attract the on-sale provisions. These offers are subject to specific alternate disclosure requirements and accordingly do not seem to give rise to the avoidance issues contemplated by the on-sale provisions.

3.6 In our proposed relief, we have not included all categories of exemptions. For example, we have excluded from our proposal the exemption available for 20 offers within 12 months under s708(1) because that exemption is expressly excluded from application to on-sales.

3.7 Our proposal below is designed to address some of these issues.

Proposal 7: Exemption-based relief

3.8 We propose that relief should be provided for the on-sale of financial products in the following circumstances:

(a) the on-sale of securities issued as part of a compromise or arrangement under Part 5.1 (ie under the statutory exemption in s708(17));

(b) the on-sale of financial products issued as consideration for a takeover bid under Chapter 6 that is accompanied by a bidder's statement (ie under the statutory exemptions in s708(18) or 1012D(7));

(c) the on-sale of:

(i) securities issued without disclosure to existing members under a dividend reinvestment plan or a bonus share plan (ie under the statutory exemption in s708(13)); and

(ii) financial products issued to clients holding a financial product of the same kind under a distribution reinvestment plan (ie under the statutory exemption in s1012D(3));

(d) the on-sale of underlying securities or financial products issued on the exercise of options or conversion of convertible securities/products where:

(i) the option or convertible security/product was issued with disclosure; and

(ii) the exercise of the option, or the conversion, did not involve any further offer;

(e) the on-sale of securities of an exempt public authority (ie securities issued under the statutory exemption in s708(21));

(f) the on-sale of securities issued:

(i) under ASIC class order relief for employee share schemes (ie Class Orders [CO 00/220], [CO 00/223], [CO 02/264], or any other case-specific relief similar to those class orders); and

(ii) on the exercise of any options issued under that relief; and

(g) the on-sale of securities and other financial products issued under ASIC class order relief for share purchase plans (ie Class Order [CO 00/194]) or any other case-specific relief similar to that class order (“share purchase plan relief”).

Rationale

3.9 In general, our rationale for providing relief for each category under Proposal 7 is that:

(a) the basis for exemption from disclosure for the issue of these financial products extends to the on-sale of the products; and

(b) any relief would not erode the anti-avoidance effect of the on-sale provisions.

Compromises and arrangements

3.10 Securities issued as part of a compromise or arrangement under Part 5.1 of the Corporations Act do not require prospectus disclosure if the compromise or arrangement was approved at a meeting held as a result of an order under s411(1) or (1A) (see s708(17)). A court approved explanatory statement is required in relation to such meetings. That statement must include, among other things, information that is material to the making of a decision by a creditor or member whether or not to agree to the compromise or arrangement.

3.11 The specific disclosure obligations for compromises and arrangements are in effect a substitute for the requirement for a prospectus in so far as the compromise or arrangement involves an offer of securities. We consider that no issue of avoidance of disclosure obligations arises in this situation. However, technically the on-sale provisions are capable of applying to securities issued under a compromise or arrangement and that relief from the operation of the on-sale provisions is warranted.

Takeovers

3.12 Where securities are issued as consideration for a takeover bid under a bidder's statement, the issue does not require disclosure because of s708(18) (if securities) or s1012D(7) (if managed investment products). In those circumstances, the bidder's statement itself must include the information that would be required to be included in a prospectus or a PDS for the offer of the securities or products (see s636(1)(g) and (1)(ga)).

3.13 Given that equivalent disclosure is required, as with compromises and arrangements, we consider that no issue of avoidance of the disclosure obligations arises. However, the on-sale provisions are technically capable of applying to securities or products issued as consideration for a takeover and again we consider that relief from the on-sale provisions is warranted.

Dividend reinvestment or bonus share plans

3.14 Issuers can issue shares to existing shareholders under dividend reinvestment or bonus share plans without prospectus disclosure under the exemption in s708(13). The underlying reasons for this statutory exemption appear to be that the need for and the cost of prospectus disclosure is not warranted because of:

(a) the information available to existing members; and

(b) the limited or small scale nature of capital raising involved.

3.15 Although on-sales are not limited to existing members, we consider that the cost considerations that underpin the statutory exemption should extend to any on-sale by shareholders within 12 months of the issue. Therefore, we consider relief from the on-sale provisions is warranted.

3.16 Similar considerations apply to financial products issued under distribution reinvestment plans.

Options and convertible securities/products

3.17 An offer of an option for the issue of a financial product requires disclosure under Part 6D.2 or 7.9 unless it is subject to a specific exclusion. If no further offer is involved in exercising the option then further disclosure is not required at the time of exercise. A new financial product is issued as a result of the exercise of the option.

3.18 Even where a disclosure document or PDS is provided in relation to the offer of an option, the issue of the underlying product on the exercise of the option arguably involves an issue without disclosure for the purposes of s707(3). This is because the disclosure document relates to the offer of the option rather than to the underlying product even though it is difficult to envisage that the document would not include information that is relevant to the underlying security (see s702 and 1011C). In these circumstances, a product issued on the exercise of an option may be affected by s707(3) if the issuer or acquirer had the requisite on-sale purpose.

3.19 The legislative policy appears to be to require disclosure at the point where the option is issued rather than at the time of exercise. It seems consistent with that policy to provide relief from the on-sale provisions for the on-sale of products issued on the exercise of the options where there had been disclosure under Part 6D.2 or 7.9 at the time of the issue of the options. Such an outcome appears to be broadly consistent with Note 1 to s702 of the Corporations Act which states:

> "Note: If a disclosure document is needed for the option and there is no further offer involved in exercising the option, the issue or sale of the underlying securities on the exercise of the option does not need a disclosure document."

3.20 Similar considerations apply for financial products issued on the conversion of a convertible or converting product.

Securities of exempt public authorities

3.21 An offer for issue of securities of an exempt public authority of a State or Territory does not require disclosure under Part 6D.2. These authorities are generally statutory bodies or other agencies of government. Some of them engage in fundraising from time to time, eg debt securities may be issued by a government agency to fund government programs. Those acquiring the securities may have a resale purpose.

3.22 As the offer of these securities for issue to any person does not require disclosure, it would not seem appropriate to require disclosure for their on-sale.

Employee share schemes

3.23 We have exempted from Part 6D.2 disclosure, issues of securities and options by listed companies under employee share schemes ("ESS"):

(a) in recognition of the need to foster better productivity by increasing opportunities for employees to invest in their employer; and

(b) on the basis of:

(i) information available to employees as a result of their special relationship with the issuer;

(ii) information available to the market through continuous obligations of the issuer; and

(ii) tailored transaction-specific information made available to the employee.

3.24 We consider that relief from the on-sale provisions for the on-sale of these securities is warranted because:

(a) the cost of disclosure under the on-sale provisions is likely to act as a disincentive for employers to establish and employees to participate in ESS;

(b) the anti-avoidance effect of the on-sale provisions is not significantly eroded by any relief because the primary purpose of ESS is not fundraising but fostering better relations between employers and employees to increase productivity; and

(c) the exemptions that we provide for an issue under an ESS are conditional on the issuer implementing various specific measures for better investor protection.

3.25 For similar reasons, we consider relief from the on-sale provisions is warranted in the case of the on-sale of securities on the exercise of options that are issued to employees without disclosure because of ASIC relief for ESS.

Share purchase plans

3.26 We have granted class order and other individual relief to enable listed issuers to make offers of shares to existing members up to the value of $3000 without prospectus disclosure under a share purchase plan (SPP). This relief is provided on the basis that the small scale of the offers involved does not justify the cost of prospectus disclosure.

3.27 In the same way, we consider that relief from the on-sale provisions for the on-sale of such securities issued without disclosure under an SPP is warranted. If the on-sale provisions apply, then the cost savings for issuers and retail clients (which is the underlying reason for the relief from the disclosure provisions for an SPP) will be lost. Further, the purpose of such offers is to allow existing shareholders to make further investments in the issuer, rather than to avoid disclosure through indirect offers to retail clients. Therefore, we believe that relief for the on-sale of securities issued under an SPP will not undermine the anti-avoidance purpose of the on-sale provisions.

Your feedback: Proposal 7

Q3.1 Are there other considerations we need to take into account in relation to any of the proposed categories of relief? Why should they be taken into account?

Q3.2 Are there other appropriate exemption-based categories of relief for on-sale? If so, what are they and why should they be given relief?

Q3.3 If relief should be granted, should it be granted on conditions? If so, what conditions and why?

Q3.4 Would it be preferable for relief of the kind set out in Proposal 7 to be effected by regulations or law reform?

Q3.5 What is the anticipated impact on issuers and retail clients if the relief of the kind set out in Proposal 7 were to be implemented?

What happens next

This discussion paper will be open for public comment for 6 weeks from 27 June 2002–8 August 2002. We will be happy to meet with stakeholders to discuss any further issues. You may contact Dhammika Amukotuwa to arrange such meetings.

We propose to settle our policy for administering the current provisions by 11 December 2002. Our options in doing so include some or all of the following:

(a) issuing class order relief, and a policy statement or information release explaining our enforcement position and the relief; and

(b) seeking that any appropriate relief be granted through regulations or law reform.

Key terms

In this discussion paper, unless the context otherwise requires, a reference to:

"acquirer" means the person to whom financial products are issued

"ASIC" means the Australian Securities and Investments Commission

"ASIC Act" means the Australian Securities and Investments Commission Act 2001

"ASX" means Australian Stock Exchange Ltd

"Corporations Act" means the *Corporations Act 2001*

"confidentiality carve-out" means the express exclusions in ASX Listing Rule 3.1 that allow the withholding of certain commercially sensitive information that would otherwise need to be disclosed by the issuer

"CO" means Class Order

"ED securities" has the same meaning as given in s111AD of the Corporations Act

"ESS" means employee share purchase plans and includes related managed investment product plans

"FSR Act" means the *Financial Services Reform Act 2001*

"interim relief" means relief provided under Class Order [CO 02/0272] as amended by Class Orders [CO 02/0334] and [CO 02/0716][]]

"old on-sale provisions" mean s707(3) and (4) of the Corporations Act before the commencement of Schedule 1 to the FSR Act

"on-sale provisions" means s707(3) and (4) and s1012C(6) and (7) of the Corporations Act

"PDS" means a Product Disclosure Statement required under Part 7.9 of the Corporations Act

"professional investor" has the same meaning as given in s9 of the Corporations Act

"retail client" has the same meaning as given in s761G of the Corporations Act

"share purchase plan relief" encompasses similar relief provided for managed investment product plans

"SPP" means a share purchase plan.

Appendix A: The on-sale provisions

Securities: s707(3) and (4)

The on-sale of securities is subject to s707(3) and (4) as follows:

(3) An offer of a body's securities for sale within 12 months after their issue needs disclosure to investors under this Part if:

(a) the body issued the securities without disclosure to investors under this Part; and

(b) either:

(i) the body issued the securities with the purpose of the person to whom they were issued selling or transferring the securities, or granting, issuing or transferring interests in, or options over, them; or

(ii) the person to whom the securities were issued acquired them with the purpose of selling or transferring the securities, or granting, issuing or transferring interests in, or options over, them;

and section 708 does not say otherwise.

(4) For the purposes of subsection (3):

(a) securities are taken to be:

(i) issued with the purpose referred to in subparagraph (3)(b)(i); or

(ii) acquired with the purpose referred to in subparagraph (3)(b)(ii);

if there are reasonable grounds for concluding that the securities were issued or acquired with that purpose (whether or not there may have been other purposes for the issue or acquisition); and

(b) without limiting paragraph (a), securities are taken to be:

(i) issued with the purpose referred to in subparagraph (3)(b)(i); or

(ii) acquired with the purpose referred to in subparagraph (3)(b)(ii);

if any of the securities are subsequently sold, or offered for sale, within 12 months after issue, unless it is proved that the circumstances of the issue and the subsequent sale or offer are not such as to give rise to reasonable grounds for concluding that the securities were issued or acquired with that purpose.

Other financial products: s707(3) and (4)

The on-sale of other financial products including managed investment products is subject to s1012C (6) and (7) as follows:

(6) This subsection covers the circumstances in which:

(a) the offer is made within 12 months after the issue of the financial products;

(b) the product was issued without a Product Disclosure Statement for the product being prepared; and

(c) either:

(i) the issuer issued the product with the purpose of the person to whom it was issued selling or transferring the product, or granting, issuing or transferring interests in, or options or warrants over, the product; or

(ii) the person to whom the product was issued acquired it with the purpose of selling or transferring the product, or granting, issuing or transferring interests in, or options or warrants over, the product.

(7) For the purposes of subsection (6):

(a) a financial product is taken to be:

(i) issued with the purpose referred to in subparagraph (6)(c)(i); or

(ii) acquired with the purpose referred to in subparagraph (6)(c)(ii);

if there are reasonable grounds for concluding that the product was issued or acquired with that purpose (whether or not there were or may have been other purposes for the issue or acquisition); and

(b) without limiting paragraph (a), a financial product is taken to be:

(i) issued with the purpose referred to in subparagraph (6)I(i);

(ii) acquired with the purpose referred to in subparagraph (6)(c)(ii);

if the financial product, or any financial product of the same kind that was issued at the same time, is subsequently sold, or offered for sale, within 12 months after issue, unless it is proved that the circumstances of the issue and the subsequent sale offer are not such as to give rise to reasonable grounds for concluding that the product was issued or acquired with that purpose.