

# Commercial Law Update

## Trustee companies, margin lending and debentures – the Feds take control

*Are you or your clients in the financial services sector? Do you deal in or advise on margin loans or margin lending facilities or debentures? Do you have involvement in estate management functions or prepare trust instruments or wills? If the answer is “yes” to any of the above questions, you will need to be across proposed new law contained in the Corporations Legislation Amendment (Financial Services) Modernisation Bill 2009 currently being considered by the Federal Parliament.*

*In its initial steps to oversee credit regulation, the Federal Government has moved to supervise a number of areas. The provision of traditional trustee company services will now require a licence and the disclosure of fees for consumers. Margin loans are to be specifically defined as financial products, margin calls are to be notified and responsible lending requirements introduced. Finally, the status of promissory notes is to be clarified.*

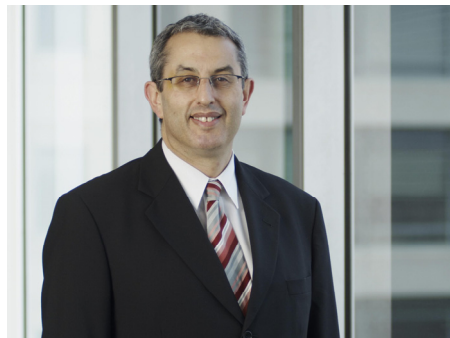
### Trustee companies

A new chapter 5D is to be inserted into the *Corporations Act* which will harmonise the regulation of trustee companies, thereby reducing the regulatory burden on them while creating a national market for trustee services. Consumers will also receive a greater measure of protection because the new law will create a national consumer protection and disclosure regime under the *Corporations Act 2001* and the *Australian Securities and Investments Commission Act 2001* (ASIC Act).

### What is being proposed for trustee companies?

Under the new legislation:

- a trustee company must be listed as a trustee company and must hold an AFSL granted by ASIC with that AFSL covering the provision of “traditional trustee company services”
- trustee companies will also be brought into the consumer protection regime for financial services set out in Chapter 7 of the *Corporations Act* and in the *ASIC Act*. This will mean compliance with the licensing, conduct, disclosure, advice, dispute



**Ian Rosenfeld Partner**  
Commercial Group Leader  
T +61 3 9321 7890  
irosenfeld@rigbycooke.com.au

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## Our Team

- Ian Rosenfeld, Partner
- Arthur Athanasiou, Partner
- Ross Levin, Partner
- Peter Dreher, Partner
- David Lawson, Partner
- Ross Higgins, Partner

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resolution and compensation provisions (as modified)

- directors will be relieved of personal liability obligations except in the limited circumstances prescribed by the Corporations Act
- trustee companies will be subject to a 15 percent limit on individual voting power and, in cases of loss of licence, may be subject to compulsory transfer of their assets and liabilities
- the fees that trustee companies may charge and how those fees are disclosed will be regulated
- a company that is not a trustee company will be prohibited from providing “traditional trustee company services”.

## What will “traditional trustee company services” include?

The following activities will be included:

- performing “estate management functions”
- preparing a will, a trust instrument, a power of attorney or an agency arrangement
- applying for probate of a will, applying for grant of letters of administration, or electing to administer a deceased estate
- establishing and operating common funds and
- any other services that may be prescribed by the regulations

The definition of “traditional trustee company services” is not limited to trustee companies. It appears to also capture an entity or person acting as a trustee of any kind, acting as an agent and also acting as a custodian of property.

## What will “estate management functions” include?

The following activities will be included:

- acting as a trustee of any kind, or otherwise administering or managing a trust;
- acting as an executor or administrator of a deceased estate
- acting as agent, attorney or nominee
- acting as manager or administrator of the estate of an individual who lacks capacity to manage his or her affairs

- acting as financial guardian of the estate of a minor
- acting as receiver or custodian of property of a person

## Fee disclosure

As indicated above, the Bill also introduces fee disclosure requirements (in the form of Part 5D.3 of the Bill). This will regulate how much a licensed trustee company is able to charge their clients for “traditional trustee company services”. Fee regulation only applies to “traditional trustee company services”. It has no application to fees for any other service that a trustee company may provide, such as acting as a superannuation trustee or being the responsible entity of a managed fund.

## Margin loans to be a financial product

Margin loans to date have been inconsistently regulated and will now be included as financial products together with “margin lending facilities” for the purposes of Chapter 7 of the *Corporations Act*. They will be given specific definitions to ensure that all arrangements with the relevant characteristics are captured under the new national regime including “Opes Prime” and “Tricom” style arrangements and hybrid products.

## Individuals only

The definition of margin loans as a financial product only extends to loans provided to individuals. It is not the Government’s intention to regulate business lending in this first phase of assuming responsibility for the regulation of credit.

Margin loans will also be subject to ASIC’s supervision and enforcement action and providers of margin loans will need:

- to be licensed (like other credit providers, advisers and brokers);
- to put in place appropriate compensation and dispute resolution arrangements;
- to give retail clients a financial services guide and a product disclosure statement providing full information about the lender or adviser and the margin loan product
- to comply with general conduct standards

## Responsible lending

In addition to the licensing, conduct and disclosure compliance with Chapter 7 of the *Corporations Act*, the reforms introduce two

new measures to address specific investor protection issues arising from margin loans. Providers will be subject to:

- a responsible lending requirement, preventing them from making a loan if it would be unsuitable for a client; and
- a requirement to notify margin calls to clients – particularly where the loan has been arranged through a financial planner.

The responsible lending requirement means that lenders will be obliged to make reasonable inquiries about the client’s financial situation and to take reasonable steps to verify it (such as by undertaking a credit check). This seeks to ensure that clients are not given loans which they are unable to service. Regulations will prescribe specific matters that lenders must take into account and ASIC will also provide guidance.

The aim is for clients to be able to meet all the repayments, fees, charges and transaction costs of complying with a margin call from income and available liquid assets, rather than from a “nest egg” or from equity in a fixed asset such as a residential property.

## Promissory notes to be treated as debentures

In the recent *Westpoint* case, the classification of promissory notes became murky and a potential regulatory gap was exposed.

The Government’s intent is that the Bill will address the anomaly so as to remove future uncertainty in the operation of the law. Disclosure requirements applicable to promissory notes and debentures will also be harmonised and two key changes will affect the regulation of debentures and promissory notes in the harmonisation process.

They are as follows:

- promissory notes with a face value of at least \$50,000.00 will come under the same regulatory regime as debentures; and
- a publicly available register of debenture trustees will be established and maintained.

Essentially, all promissory notes will be treated as debentures under the Bill which will mean that the issue of promissory notes will entail the issue of a trust deed, the appointment of a trustee and the issue of a prospectus (unless the offer falls within one of the exemptions from disclosure in Chapter 6D (fundraising) of the *Corporations Act*).

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## When will the changes be effective?

The reforms in relation to trustee companies and margin loans are proposed to take effect on a date to be fixed by Proclamation.

However, if any of the provisions do not commence within six months from the day the Bill receives Royal Assent, they commence on the first day after the end of that period.

The reform relating to the harmonisation of the regulation of promissory notes is proposed to take effect on the day Royal Assent is received.

The Bill follows an in-principle agreement on 26 March 2008 by the Council of Australian Governments (COAG) to transfer the responsibility for regulating mortgage credit and advice, margin loans and trustee companies to the Commonwealth.

## Regulations now released

Following the Bill's introduction, the Federal Government has also released draft regulations to support the Bill's operation which clarify many of the more practical issues.

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Level 13, 469 La Trobe Street  
Melbourne Vic 3000  
T 61 3 9321 7888  
F 61 3 9321 7900  
[www.rigbycooke.com.au](http://www.rigbycooke.com.au)