
Has the Financial Services Reform Act fixed the problems with the regulation of securities and derivatives?

Benjamin B Saunders*

The Financial Services Reform Act 2001 (Cth) introduced new definitions of “derivative” and “financial product” into the Corporations Act 2001 (Cth), and replaced the separate regulatory regimes governing futures contracts and securities with a single financial markets authorisation regime and a single intermediary licensing regime. This article examines the reforms to evaluate whether they have been successful. It is argued that there are definite improvements resulting from the reforms, and the scope for regulatory arbitrage has been greatly reduced. However, numerous problems remain. There are significant differences in the regulation of securities and derivatives. The distinction between securities and derivatives is still based on legal characteristics, not economic function. There is uncertainty as to the exact scope and interaction of the definitions, particularly with respect to equity derivatives, warrants and options. The current law has thus not fully addressed many of the problems that existed prior to the reforms.

INTRODUCTION

It was widely acknowledged that the characterisation and regulation of derivatives and securities prior to the enactment of the *Financial Services Reform Act 2001 (Cth)* (FSR) was unsatisfactory. The law was criticised for being uncertain, allowing regulatory arbitrage and regulating functionally equivalent products in an inconsistent manner.

FSR made wide-ranging amendments to the *Corporations Act 2001 (Cth)*¹ which were intended to rectify these problems. FSR introduced new definitions of “derivative” and “financial product”, purporting to apply a functional approach which regulated all products that performed a similar function in a similar manner.

The purpose of this article is to examine these reforms to determine whether they have successfully achieved their goal. A particular focus of this article is to examine whether the rhetoric of functional regulation has been achieved. This article is not a general treatment of the regulation of securities and derivatives.²

It will be argued that while there are definite improvements from the reforms, and the scope for regulatory arbitrage has been greatly reduced, numerous problems remain. Despite the umbrella definition of “financial product”, there are still significant differences in the regulation of securities and derivatives. The distinction between securities and derivatives continues to be based on legal characteristics, not economic function. Finally, there is uncertainty as to the exact scope and interaction of the definitions, particularly with respect to equity derivatives, warrants and options. The current law thus perpetuates many of the problems that existed prior to the enactment of FSR.

* BA, LLB (Melb); Solicitor, Macpherson + Kelley Lawyers. This article is an edited version of a paper that was joint winner of the Banking and Financial Services Law Association’s 2009 Research Prize.

¹ Unless otherwise stated, legislative references in this article are to the *Corporations Act*.

² This article only considers the securities and financial services provisions in Chs 6CA, 6D and 7 of the *Corporations Act*, and not the other provisions relevant to securities and derivatives contained elsewhere in the Act. Note that different definitions of “security” apply for the purposes of different parts of the Act.

PRIOR REGULATION AND BACKGROUND TO REFORM

A brief overview of the regulation of securities and derivatives in the *Corporations Law* (Cth) prior to FSR is provided below.³ The *Corporations Law* contained two separate regimes for the regulation of securities (contained in Ch 7) and futures contracts (contained in Ch 8). The regimes were separate and self-contained, so that if a product fell within the definition of security it would be regulated exclusively by Ch 7 and futures contracts were regulated exclusively by Ch 8.

The definition of securities

Securities were defined, by a process of inclusion and exclusion,⁴ as follows:

- (a) debentures, stocks or bonds issued or proposed to be issued by a government;
- (b) shares in, or debentures of, a body;
- (c) prescribed interests;
- (d) units of such shares or of prescribed interests;
- (e) an option contract within the meaning of Ch 7;

but not including a futures contract or an excluded security.⁵

The concept of “prescribed interest” in para (c) has been replaced by the managed investment scheme provisions of the *Corporations Act*.⁶ “Unit” (para (d)) was defined as a legal or equitable right or interest in a share, debenture or other interest, including an option to acquire such a right or interest.⁷ An “option contract” (para (e)) had three branches, namely an option to buy or sell securities, or a contract entered into on a securities exchange or an exempt stock market, under which a party acquires an option or right:

- (i) to buy or sell an amount of a foreign currency, or a quantity of a specified commodity, at a specified price; or
- (ii) to be paid an amount of money determined by reference to a specified index.

The definition of derivatives

There was no generic definition of derivative under the pre-FSR law. Chapter 8 instead regulated “futures contracts”, defined to include the following four categories:⁸

- an eligible commodity agreement, which was a deliverable futures contract that was settled otherwise than by delivery of the underlying commodity;⁹
- an adjustment agreement, defined as a standardised agreement under which a person will pay or receive an amount of money calculated by reference to a set of circumstances;¹⁰
- a futures option, which gave the holder the option to assume a bought or sold position under an eligible commodity agreement or adjustment agreement;¹¹
- an eligible exchange traded option, which was a contract entered into on a futures market that gave the right to buy or sell a futures contract.¹²

³ Cf Giuffre R, “Regulation of the Commodity Futures market in Australia” (1982) 5 UNSWLJ 170, for a review of the law prior to the *Futures Industry Act 1986* (Cth), the predecessor to the *Corporations Law* (Cth). See also Ciro T, “Anti-speculation Laws and Financial Markets Regulation in Australia and the United States” (2002) 13 JBFLP 15, for a history of financial derivatives regulation.

⁴ Baxt R, Ford HAJ and Black A, *Securities Industry Law* (5th ed, Butterworths, 1996) p 16.

⁵ *Corporations Law*, s 92(1).

⁶ Hanrahan PF, *Managed Investments Law & Practice* (CCH, subscription service) Ch 2.

⁷ *Corporations Law*, s 9.

⁸ *Corporations Law*, s 72.

⁹ *Corporations Law*, s 9.

¹⁰ *Corporations Law*, s 9.

¹¹ *Corporations Law*, s 9.

¹² *Corporations Law*, s 9.

Excluded from the definition were currency swaps, interest rate swaps, and forward exchange rate and interest rate contracts to which an Australian bank or merchant bank was a party. If a product fell within this exemption or simply fell outside the definition of futures contract, then it was not subject to regulation under Ch 8.

The regulation of securities and futures contracts

The two regimes had many common features.¹³ Both required intermediaries to be licensed and to adhere to other competence rules,¹⁴ and both imposed conduct of business rules such as the provision of contract notes¹⁵ and the maintenance of separate accounts for client funds.¹⁶ Brokers were also subject to auditing and supervision rules.¹⁷ There were similar prohibitions in both regimes such as insider trading, market manipulation, false trading, false statements and fraudulently inducing persons to deal.¹⁸

There were also a number of important differences. For example, securities dealers had to disclose commissions¹⁹ whereas futures brokers did not; futures brokers were required to report monthly to clients²⁰ and securities dealers were not. Disclosure requirements differed considerably: futures brokers were required to explain to clients the nature of futures contracts and the risks related to futures trading,²¹ whereas offers of securities required full prospectus disclosure.²² Futures contracts were required to be traded on a futures market²³ unless transacted on an “exempt futures market”,²⁴ whereas securities could be traded on or off a stock exchange.

The LEPO case

Crystallising the problems with this legislative regime was the decision of the Full Federal Court in the LEPO case.²⁵ The Australian Stock Exchange (ASX) in 1994 announced its intention to commence trading Low Exercise Price Options (LEPOs), which were deep-in-the-money European-style call options (ie options with a low exercise price).²⁶ The Sydney Futures Exchange (SFE) initiated proceedings, claiming that LEPOs were futures contracts and that the ASX would be conducting an unauthorised futures market in breach of the law. In order for this to be the case, LEPOs had to fall under the first category of futures contract, namely eligible commodity agreement. The court held that shares were not commodities and therefore did not fall within the definition of “eligible

¹³ Companies and Securities Advisory Committee, *Law of Derivatives: An International Comparison* (1995) p 28. See also Gunningham N, “Futures Market Regulation in Australia – Part I” (1992) 66 ALJ 59 at 62-63.

¹⁴ Companies and Securities Advisory Committee, n 13, p 50.

¹⁵ *Corporations Law*, ss 842, 1206.

¹⁶ *Corporations Law*, ss 866, 1208.

¹⁷ *Corporations Law*, Pts 7.5, 8.5.

¹⁸ *Corporations Law*, Pts 7.11, 8.7.

¹⁹ *Corporations Law*, s 849.

²⁰ *Corporations Law*, s 1207.

²¹ *Corporations Law*, s 1210.

²² *Corporations Law*, Pt 7.12.

²³ *Corporations Law*, s 1258.

²⁴ *Corporations Law*, s 1127. The Australian Securities Commission set out its policy on who would be granted exempt futures market status in Policy Statement 70 (now withdrawn).

²⁵ *Sydney Futures Exchange Ltd v Australian Stock Exchange Ltd* (1995) 56 FCR 236 (Full Federal Court).

²⁶ For a more detailed description, see *Sydney Futures Exchange Ltd v Australian Stock Exchange Ltd* (1995) 56 FCR 236 at 246-251, 260-263, 278-283.

commodity agreement” within the meaning of s 72.²⁷ As a result, LEPOs were properly characterised as securities and regulated under Ch 7 of the *Corporations Law*.²⁸

The decision was controversial and widely seen as illustrating the problems with the regimes.²⁹ One crucial point to note is that the outcome of the case turned on a technical interpretation of the relevant statutory provisions (described by one commentator as “seemingly irrelevant criteria”)³⁰ without regard to the economic function of the LEPOs.³¹ This was due to the nature of the definitions of security and futures contract, both of which consisted of a collection of definitions based on the legal characteristics of the products sought to be regulated.³² Neither contained a unifying characteristic that captured the “essence” of the definition.

Calls for reform

Numerous problems were noted with this position, in particular the following.³³ First, products which fell outside the definitions of security or futures contract would not be regulated as a futures contract or as a security, and due to the rigidity of the definitions, it was relatively easy to structure products to avoid regulation.³⁴ Secondly, there was uncertainty as to the regulation of complex products, as illustrated by the LEPO case.³⁵ Thirdly, the regimes led to inconsistency, as different requirements applied to products with similar functions.³⁶ Finally, the definitions were inflexible and required amendment to permit the trading of new products.³⁷ As a result of these problems, a number of inquiries were initiated to review the position and provide recommendations for reform.³⁸

In 1997 the Wallis Inquiry handed down its review of the financial system, the *Financial System Inquiry Final Report* (FSI).³⁹ FSI advocated a functional approach to financial regulation, where the separate regimes for securities and other financial products would be replaced by a single regime for the regulation of “financial products”. A principles-based approach would ensure that functionally equivalent products would be regulated in a similar manner and eliminate the gaps and inconsistencies in the law.⁴⁰ FSI also recommended that disclosure requirements be comparable for similar products.⁴¹

Subsequent to FSI, the Companies and Securities Advisory Committee (CASAC) handed down its review of the law applying to derivatives.⁴² CASAC recommended a single authorisation for financial

²⁷ *Sydney Futures Exchange Ltd v Australian Stock Exchange Ltd* (1995) 56 FCR 236 at 255-259 (Lockhart J), 270-272 (Gummow J), 298-299 (Lindgren J).

²⁸ The decision also highlighted the absurd fact that it was the identity of the market that determined the classification of option contracts as securities or futures: *Sydney Futures Exchange Ltd v Australian Stock Exchange Ltd* (1995) 56 FCR 236 at 267 (Gummow J).

²⁹ Cf Haselden L, “Recent Amendments to the Corporations Law and Licensing Requirements” (1995) 9 CLQ 20 at 21.

³⁰ Lawrence J, “The Regulation of Derivatives and the LEPOs Litigation” (1996) 14 C&SLJ 90.

³¹ Currie J and Lonie J, “LEPOs: Claytons Futures Contracts are ‘Securities’” (1995) 6 JBFLP 133.

³² Cf Hains MG, *Futures Contracts: The Need for Re-Characterisation* (PhD thesis, University of Sydney, 1996) Ch 3.

³³ For further problems, see Markovic M, “The Legal Status of Futures Market Participants in Australia” (1989) 7 C&SLJ 82.

³⁴ O’Sullivan J, “Derivatives: A Survey of the Law and Practice” (1994) 6 JBFLP 89 at 94.

³⁵ Companies and Securities Advisory Committee, n 13, pp 19-27.

³⁶ Australia, *Financial System Inquiry Final Report* (AGPS, 1997) p 278.

³⁷ Australia, n 36.

³⁸ Following the LEPO case the *Corporations Law (Securities and Futures) Amendment Act 1995* (Cth) was enacted as an interim measure pending the outcome of the Companies and Securities Advisory Committee review, which allowed regulations to regulate particular products as if they were securities or futures contracts: Donnan F, “The Share Ratio Act: Innovation or Experimentation in Securities Regulation?” (1996) 14 C&SLJ 101.

³⁹ Australia, n 36.

⁴⁰ Australia, n 36, p 279.

⁴¹ Australia, n 36, pp 261-264.

⁴² Companies and Securities Advisory Committee, *Regulation of On-exchange and OTC Derivatives Markets: Final Report* (1997).

exchanges and advocated a generic definition of derivatives so that the distinction between securities and derivatives would be based on the function of the relevant instrument, rather than “artificial product distinctions”.⁴³ For products that potentially satisfied both definitions, the definition of security should take precedence.⁴⁴

The final review to consider the question, the Corporate Law Economic Reform Program (CLERP) Paper No 6, stated that the distinction between securities and derivatives was disappearing, that their functions were converging and so separate regulation of derivatives and securities was no longer satisfactory.⁴⁵ The paper noted that regulation based on legal distinctions was inherently inflexible and likely to become redundant due to product innovation. Purporting to apply a functional approach, the paper proposed a new definition of “financial instrument” to replace the existing provisions.⁴⁶ Despite arguing that securities were functionally equivalent, however, the paper stated that separate disclosure regimes for securities and derivatives would be retained.⁴⁷

FSR purported to implement many of these recommendations and introduce a functional approach that regulated similar products on a consistent and competitively neutral basis.⁴⁸ The Explanatory Memorandum noted that the new definition of “derivative” was intended to focus on the “functions or commercial nature of derivatives rather than trying to identify each product that will be regarded as a derivative”.⁴⁹ The intention was thus to implement an approach which focused on the economic functions performed by a product rather than its technical legal characteristics.

CURRENT REGULATION POST-FSR

The separate regulation of securities and futures contracts has been replaced by a more general regime covering “financial products and services” under Ch 7 of the *Corporations Act*. Ch 7 regulates the licensing of financial markets and intermediaries, product disclosure and other matters. Central to the FSR regime is the definition of “financial product”, an umbrella term which includes both securities and derivatives.⁵⁰ Key reforms include a single financial markets authorisation regime and a single intermediary licensing regime, covering both securities and derivatives intermediaries.

Although both securities and derivatives come under the umbrella definition of financial product, there remains a clear distinction between the two concepts. There are important differences between the disclosure provisions for securities (contained in Ch 6D) and financial products including derivatives (contained in Pt 7.9), as will be seen later. In most other respects, securities and derivatives are regulated on a consistent basis.

For relevant purposes, “security” is defined to mean:

- (a) a share;
- (b) a debenture;
- (c) a legal or equitable right or interest in a share or debenture;
- (d) an option to acquire, by way of issue, a share or debenture; or
- (e) a right to acquire, by way of issue, the following under a rights issue:
 - (i) a security covered by para (a), (b), (c) or (d);

⁴³ Companies and Securities Advisory Committee, n 42, pp 8-9.

⁴⁴ Companies and Securities Advisory Committee, n 42, pp 69-70.

⁴⁵ Australian Treasury, *Financial Markets and Investment Products: Promoting Competition, Financial Innovation and Investment*, Corporate Law Economic Reform Program, Proposals for Reform: Paper No 6 (AGPS, 1997) p 36.

⁴⁶ Australian Treasury, n 45, Pt 4.

⁴⁷ Australian Treasury, n 45, p 110.

⁴⁸ Revised Explanatory Memorandum, *Financial Services Reform Bill 2001* (Cth) pp 1-19.

⁴⁹ Revised Explanatory Memorandum, *Financial Services Reform Bill 2001* (Cth) at [6.80].

⁵⁰ *Corporations Act*, s 764A(1)(a), (c).

- (ii) an interest or right covered by s 764A(1)(b) or (ba) (ie an interest in a managed investment scheme).⁵¹

It will be noted that the definition has similarities with the previous definition and adopts the same inclusion/exclusion method of defining its subject matter. The concepts of “share” and “debenture” will not be examined in detail in this article, for, although there may be some complexity in their proper characterisation,⁵² these concepts have a generally understood meaning and have equivalent provisions in the former law. Paragraph (c) will be discussed further below. Paragraph (d) of the definition has a flow-on meaning from the concepts of share and debenture, and provides that an option to acquire unissued shares or debentures is a security. It is beyond the scope of this article to discuss para (e) (rights issues).

The concept of futures contract has been replaced by a generic definition of “derivative”, which is defined as an arrangement under which a person may be required to provide consideration to another party, and the consideration to be provided is derived from or varies by reference to something else.⁵³ Excluded from the definition are contracts for delivery of tangible property and contracts for the future provision of services.⁵⁴ There is also a carve out for securities,⁵⁵ so that where a product potentially falls under both categories the security definition takes precedence.

CRITIQUE

Benefits of the post-FSR regime

Given the breadth of the definition of derivative, there are much fewer opportunities for products to fall between the cracks and escape regulation, as was the case under the old regime. There is now little doubt that the majority of instruments normally thought of as derivatives (for example, futures, credit derivatives, interest rate and other swaps) will be caught by the definition of derivative. This represents a considerable improvement on the former position.

The major areas of uncertainty now relate to the reach of the definition of derivative including whether it improperly applies to certain arrangements, and the interaction of the securities, derivatives and managed investment scheme provisions, rather than whether a product will be regulated at all. In particular, it is uncertain how equity derivatives are regulated under the current regime.⁵⁶

Nature of the definitions

The functional approach to regulation proposes that all instruments that perform a similar economic function be regulated in a consistent manner.⁵⁷ FSR purported to implement a functional approach to the regulation of derivatives, intending to focus on “the functions or commercial nature of derivatives” rather than their legal characteristics.⁵⁸ The legislation has also retained the distinction between securities and derivatives, with (as will be shown) significant differences in the regulatory treatment applicable to each.

Given that this is the case, we should be entitled to expect that an analysis of the economic functions of securities and derivatives has been undertaken and that the definitions reflect this analysis. We should also expect that the different regulatory treatment appropriately takes into account these different functions.

⁵¹ *Corporations Act*, s 761A (definition of “security”). Note that this definition applies for the purposes of Chs 6D and 7, and that s 92 contains different definitions for other parts of the *Corporations Act*.

⁵² Cf Pennington R, “Can Shares in Companies be Defined?” (1989) 10 Co Law 140.

⁵³ *Corporations Act*, s 761D(1).

⁵⁴ *Corporations Act*, s 761D(3)(a), (b).

⁵⁵ *Corporations Act*, s 761D(3)(c).

⁵⁶ Ciro T, “Trading in Financial Derivatives: Does it Increase Market Volatility and Systemic Risk?” (2004) 22 C&SLJ 23 at 41.

⁵⁷ Merton RC and Bodie Z, “Financial Infrastructure and Public Policy” in Crane DB, Froot KA, Mason SP, Perold AF, Merton RC, Bodie Z, Sirri ER and Tufano P (eds), *The Global Financial System: A Functional Perspective* (Harvard Business School Press, 1995) p 269.

⁵⁸ Revised Explanatory Memorandum, *Financial Services Reform Bill 2001* (Cth).

Unfortunately, this is not the case. The definitions continue to be based on technical legal characteristics and not economic function. The definition of “security” is a collection of instruments broadly related by the theme of fundraising, although this is not stated, and as will be seen, the scope of the definition is unclear. The definition still operates by a “rigid” process of inclusion/exclusion,⁵⁹ as was the case under the former position.⁶⁰ Paragraph (e) of the definition exemplifies this, with the result that an interest in a registered scheme is not a security but a right to acquire one by way of a rights issue is.

A “derivative” is defined as an instrument under which consideration is to be paid, calculated with respect to something else. In and of itself, it is a broad and arbitrary definition, for although all derivatives that are intended to be regulated possess these characteristics, the definition requires numerous limitations and carve outs to give it meaningful application.⁶¹

In neither case is there an express statement of purpose capturing the “essence” of what is to be regulated, rather, the instruments are defined according to the legal characteristics they possess. As a result, the question of whether an instrument is a security or a derivative is resolved by a determination of whether or not it possesses those legal characteristics. If a modern-day LEPO case were to arise under the current law, the question would be resolved in exactly the same manner as in that case: a technical examination of the product to determine whether it had the characteristics listed in the respective definitions.

The deficiencies of this position take on added importance when a number of factors are considered. First, “derivative” is defined very broadly and may apply to a wide range of arrangements not properly thought of as derivatives, for example, future sales of intangible property.⁶² The second factor relates to the interaction between the definitions of security and derivative. Any product which is a security is taken not to be a derivative,⁶³ which again appears to be an arbitrary dividing line, for it means that certain products which would ordinarily be considered derivatives (such as warrants and options) may be characterised as securities.⁶⁴ Without a definitive functional approach, these issues can be resolved only by a technical analysis of the statutory provisions.

It is also important to note that the umbrella term “financial product”, encompassing both securities and derivatives, is not a solution to the problem.⁶⁵ As will be shown, important consequences still flow from an instrument being characterised as a security or a derivative.

The scope of the definition of security

Under para (c) of the definition, “security” includes “a legal or equitable right or interest” in a share or debenture of a body. There is uncertainty as to the exact scope of this definition. This provision had its origins in the concept of unit,⁶⁶ and is probably intended to mean something like “an ownership interest in a share, falling short of complete legal or beneficial ownership”.⁶⁷ It was clearly intended that exchange traded options would fall under the definition of derivative and not be regulated as

⁵⁹ Glover T, “HYENAS are not Debentures, Securities or Options to Acquire Shares under the Corporations Act 2001” (2002) 20 C&SLJ 122.

⁶⁰ Lewis K, “When is a Financial Product not a Financial Product?” (2004) 22 C&SLJ 103 at 105-106.

⁶¹ Cf Chellew J, “The FSR Act’s Derivative Definition: Cleaning up the Intraday Contract Problem” (2005) 16 JBFLP 114 at 114.

⁶² Farrell S, “Derivatives”, in Mallesons Stephen Jaques, *Australian Finance Law* (6th ed, Lawbook Co., 2008) p 85.

⁶³ *Corporations Act*, s 761D(3)(c).

⁶⁴ Although note that disclosure requirements for warrants have been modified by the *Corporations Regulations 2001* (Cth) (discussed further below).

⁶⁵ Cf Glover, n 59 at 125, arguing that the introduction of the definition of financial product would go some way to addressing the defects with the definition of security.

⁶⁶ Baxt R, Black A and Hanrahan P, *Securities and Financial Services Law* (7th ed, LexisNexis, 2008) p 107.

⁶⁷ Cf Explanatory Memorandum, *Companies Bill 1981* (Cth) p 38.

securities,⁶⁸ and most discussions of the subject take this view.⁶⁹ However, the provision is drafted extremely broadly and may apply to a range of instruments which it was not intended to capture.

Drawing from the equivalent provision in the takeover context,⁷⁰ a contractual right to acquire a share constitutes an interest in shares.⁷¹ A call option is a legal right to acquire a parcel of shares the subject of the option.⁷² The ASX Market Rules define a call option as a contract that gives the buyer the right to purchase the underlying financial products at the exercise price.⁷³ This would seem to satisfy the description of a right or interest in those shares, and so a call option would be a security. A number of cases confirm that an option grants an equitable interest in the property the subject matter of the option.⁷⁴

Although some caution is advisable,⁷⁵ this reasoning is supported by s 710, which implies that “an option over securities”, which can only refer to an option over *issued* securities,⁷⁶ is subject to the Ch 6D disclosure requirements.⁷⁷ The only way that this could be the case is if an option over issued securities was a security within para (c) of the definition.⁷⁸

Accordingly, contrary to the legislative intention, it is at least arguable that call options are securities.⁷⁹ It may be that the courts will resolve the issue to the contrary,⁸⁰ nevertheless, the point remains that there is uncertainty as to the exact scope of the definition, compounded by the lack of a functional approach to the definition of security.

This paragraph also creates inconsistencies in relation to other products. The Administrative Appeals Tribunal (AAT) in the HYENA case held that put options, options to dispose of securities, were not securities.⁸¹ Warrants can be either securities or derivatives, depending on their type, and it is difficult to generalise, given the wide variety of types of warrants.⁸² Warrants that are issued as part of a cover arrangement, such as fully-covered warrants and instalment warrants, will be securities, however, where there is no interest in an underlying security the instrument will not be a security.⁸³

Disclosure requirements for warrants have been modified by the *Corporations Regulations 2001* (Cth) (Regulations), which is discussed below. This regulatory treatment is unsatisfactory given that

⁶⁸ Revised Explanatory Memorandum, *Financial Services Reform Bill 2001* (Cth) at [6.72].

⁶⁹ Cf Clayton Utz, *The Essential Guide to Financial Services Reform* (CCH, 2002) p 321.

⁷⁰ *Corporations Act*, s 606(2).

⁷¹ Renard I and Santamaria JG, *Takeovers and Reconstructions in Australia* (Butterworths, subscription service) at [404].

⁷² *Hannes v Director of Public Prosecutions (Cth) (No 2)* (2006) 205 FLR 217 at [585].

⁷³ *ASX Market Rules*, Sch 4, p 32.

⁷⁴ *Commissioner of Taxes (Qld) v Camphin* (1937) 57 CLR 127 at 132; *Hill v Terry* (1993) 2 Qd R 640 at 647. This argument was made in *Australian Securities and Investments Commission v Online Investors Advantage Inc* (2005) 194 FLR 449, but the point was not decided in that case.

⁷⁵ Section 710 may not be a completely reliable guide, as item 1 of the table in s 710 refers to interests in a managed investment scheme, which are no longer subject to the prospectus disclosure requirements.

⁷⁶ As an option to acquire *unissued* securities would itself be a security by virtue of para (d) of the definition of security.

⁷⁷ Note that a distinction is drawn between “a legal or equitable right or interest in securities” and “an option over securities”.

⁷⁸ Cf s 702 which provides that “an offer of an option over securities is not to be taken to be an offer of the underlying securities”, and that “an offer to grant an option is taken to be an offer to issue the security constituted by the option”. Accordingly, an option over an issued security would only be caught by Ch 6D if it were itself a security.

⁷⁹ Tony Ciro also notes this possibility: Ciro T, “The Regulation of Equity Derivatives: Functional Rhetoric v Economic Substance” (2002) 20 C&SLJ 276 at 282.

⁸⁰ In *Australian Securities and Investments Commission v Giann & Giann Pty Ltd* (2005) 141 FCR 278 at 280, Finkelstein J stated that exchange traded options were derivatives. Note also *Australian Securities and Investments Commission v Online Investors Advantage Inc* (2005) 194 FLR 449.

⁸¹ *Macquarie Bank Ltd v Australian Securities and Investments Commission* (2001) 39 ACSR 508.

⁸² Australian Securities Exchange, *Warrants: Understanding Trading and Investment Warrants* (12th ed, 2007) <http://www.asx.com.au/warrants> viewed 9 February 2010.

⁸³ Australian Securities and Investments Commission, *ASIC News*, No 51 (2002).

FSR purported to introduce a functional approach, as many of these products serve similar economic functions. The key point to be noted is that, as with the former regime, the proper characterisation in each case is to be resolved by a technical analysis of the legislative provisions.

Warrants

The legislative intention is that the issue by a body of its own securities would be subject to the disclosure provisions of Ch 6D, and the issue of other financial products would be subject to the disclosure provisions of Ch 7. It was noted above that certain types of warrants fall within the definition of security. This position is modified somewhat by the Regulations. The Regulations define “warrant” (for relevant purposes) as:

- (i) a derivative under s 761D of the Act; or
- (ii) a financial product that would be a derivative but is a security because of para (c) of the definition of security (ie a legal or equitable right or interest in a share or debenture)

that is transferable.⁸⁴

By virtue of the Regulations, a warrant that is a security is exempted from Ch 6D⁸⁵ and all warrants are subject to the financial product disclosure provisions of Pt 7.9.⁸⁶ Such products do not lose their character as securities due to these Regulations, but are simply regulated differently for the purposes of disclosure and certain other provisions. For the purposes of other parts of the financial services laws (such as Pts 7.6 and 7.10), they remain regulated as securities. This was done to make it clear that hybrid securities are regulated as derivatives for the purposes of the disclosure requirements,⁸⁷ effectively reversing the securities carve out from the definition of derivative.⁸⁸

This produces the absurd result that these products are defined and characterised as securities, but regulated (for important purposes) as derivatives. One consequence of this is that product issuers would need to be authorised as licensees to issue securities, but would need to comply with the product disclosure requirements of Pt 7.9, and not the securities disclosure regime in Ch 6D, when issuing such products. Further, any financial market seeking to trade such products would need to be authorised to trade in securities. Notably, the SFE is authorised to trade derivatives on its financial market, but not securities.⁸⁹ Accordingly, the SFE is not authorised to conduct a market for warrants and options which are securities, and may be in breach of s 791A if it does so.

This indicates that the definition of security is defective, applying to products and instruments which are not appropriately regulated as securities. The ad hoc “now you’re in, now you’re out” definitional approach – where warrants fall under the general description of derivative,⁹⁰ but are regulated as securities by the carve out in s 761D(3)(c), with this position then being reversed by the Regulations – indicates a lack of a meaningful functional distinction between the definitions.

Uncertainty as to the applicable regime

The definitions of security and derivative lead to uncertainty and inconsistency as to the applicable regime in certain situations. It is possible to structure products that would normally be thought of as “equity capital” in such a way as to avoid the definition of security. For example, para (d) of the definition of security includes an option to acquire a share by way of issue. An instrument could be structured so that the issue of shares is not at the option of the holder but takes place upon the occurrence of some other event, such as mandatory conversion. Another possibility may be where the option is part of a broader financial instrument or facility, so that it is not of itself an option to acquire shares.

⁸⁴ *Corporations Regulations*, reg 1.0.02.

⁸⁵ *Corporations Regulations*, reg 6D.5.01.

⁸⁶ *Corporations Regulations*, reg 7.9.07A.

⁸⁷ Explanatory Statement, *Corporations Amendment Regulations 2002 (No 2) 2002* (Cth).

⁸⁸ *Corporations Act*, s 761D(3)(c).

⁸⁹ See *Australian Market Licence (Sydney Futures Exchange Limited) Variation Notice 2004 (No 1)* (Cth), Sch 1, cl [2].

⁹⁰ *Corporations Act*, s 761D.

An interesting arbitrage opportunity is also created by the interplay between the Australian Prudential Regulatory Authority's (APRA) prudential standards and the *Corporations Act*. APRA permits a range of instruments which qualify as tier 1 and 2 capital, including instruments which provide for mandatory conversion into ordinary securities.⁹¹ This allows products to be structured to raise funds and boost the issuer's regulatory capital while also avoiding the securities disclosure regime.

An example of this is the issuance of *Convertible Preference Securities* (CPS) by Macquarie in 2008. The CPS were structured as interests in a registered scheme, which (among other possible outcomes) may convert into ordinary shares in Macquarie Group Ltd if certain conditions are satisfied.⁹² Although convertible into shares, the CPS avoid para (d) of the definition of security as the conversion is not at the option of the holder.⁹³

A search of the ASX website reveals that numerous products are structured in a similar fashion,⁹⁴ whereas other hybrid products are structured as securities.⁹⁵ As these products serve the same purpose, namely to raise funds for the issuing entity⁹⁶ (and often to strengthen the issuer's regulatory capital position for the purposes of prudential standards), the goal of regulating products which serve the same economic function in the same manner is not being achieved.

Further, a range of products, in particular warrants and options, which are interests in shares or debentures may potentially be securities, even where issued by unrelated product issuers. These products are normally thought of as serving the functions of derivatives and not securities.⁹⁷ Thus, again, functionally equivalent products are characterised differently. The position is complicated by the fact that the disclosure requirements for warrants have been amended by the Regulations. This has the result that these products are characterised as securities, but regulated as derivatives, as discussed above.

There also appears to be uncertainty as to whether the determining factor is the nature of the *product* issued, or the structure of the *issuing entity*. For example, notes or debentures issued by a company will be securities offered pursuant to a prospectus,⁹⁸ whereas similar instruments issued by a managed investment scheme may take the form of a prospectus,⁹⁹ or a combined prospectus and product disclosure statement (PDS).¹⁰⁰ Hybrids also exhibit considerable variation in market practice.

⁹¹ Australian Prudential Regulatory Authority, *Capital Adequacy: Measurement of Capital*, Prudential Standard APS 111 (2008) Attachment A, p 33.

⁹² Macquarie Convertible Preference Securities Product Disclosure Statement issued by Macquarie Capital Loans Management Ltd as responsible entity for the Macquarie CPS Trust (5 June 2008).

⁹³ Similar principles apply in relation to the offer of "TICKETS", Tradeable Interest-bearing Convertible to Equity Trust Securities, Prospectus and Product Disclosure Statement issued by Macquarie Airports Management Ltd as responsible entity for Macquarie Airports Reset Exchange Securities Trust (13 November 2004).

⁹⁴ For example, PERLS II (Perpetual Exchangeable Resetable Listed Securities) issued/promoted by the Commonwealth Bank of Australia, ASSETS (Australand Subordinated Step-up Exchangeable Trust Securities), Goodman Plus Trust.

⁹⁵ See the list of hybrids traded on the Australian Stock Exchange, <http://www.asx.com.au/asx/markets/interestRateSecurityPrices.do> viewed 17 February 2010.

⁹⁶ Paterson I and Eliakim D, "Hybrid Securities" in Mallesons Stephen Jaques, n 62, p 200.

⁹⁷ Australian Stock Exchange, n 82, p 4.

⁹⁸ Due to para (b) of the definition of security. Examples are numerous and include Esanda Debenture Prospectus 83, Balanced Securities Prospectus No 9 (29 February 2008), Angas Securities Ltd First Ranking Debenture Stock Prospectus No 8 (4 October 2007).

⁹⁹ For example, the Record Realty Notes Prospectus issued by Record Funds Management Ltd as responsible entity for Record Realty (10 July 2006), Prospectus for the "FIELDS" Unsecured Note Issue (Floating Interest Energy LinkeD Securities) issued by Westpac Funds Management Ltd as responsible entity for the Australian Energy Income Fund (9 August 2004).

¹⁰⁰ For example, ING Industrial Fund Prospectus and Product Disclosure Statement for Convertible Loan Securities (14 September 2006).

Hybrid securities issued by a company will be by way of a prospectus,¹⁰¹ whereas instruments with similar characteristics and similar purposes issued by a registered scheme will be in the form of a PDS.¹⁰²

Another instance of uncertainty is noted by Julian Donnan, who argues that it is not clear how instruments where the repayment of a proportion of the face value is contingent upon certain events will be regulated under the *Corporations Act*.¹⁰³

Therefore, many of the key problems identified with the former regime persist under the current law. It is uncertain how some products will be, or should be, regulated. Considerable variation is evident in market practice, suggesting that the distinction between the various categories is not clear, and that no coherent policy rationale is apparent from the legislation. Instruments and products with similar economic functions, issued for the same purpose, are regulated differently as a result of the legal structures adopted. This differential treatment of functionally equivalent products, and the ability to structure instruments to avoid characterisation as securities, is inconsistent with the FSR's rhetoric of functional regulation.¹⁰⁴

Clearly, it is the complex, unusual cases which pose challenges for the regulatory scheme, for there will be no doubt as to how the majority of products will be regulated. But as with the LEPO case, it is the innovative products which test the appropriateness of the regulatory structure. Without a definitive functional approach, inconsistencies and arbitrage will continue to exist.

Philosophy of securities and derivatives regulation

Although securities and derivatives both fall under the umbrella of "financial product", the disclosure requirements applicable to securities and derivatives are very different. The legislation thus clearly differentiates between the two categories, but there is no clearly articulated policy rationale as to why there should be such a sharp difference.

Discussions of the philosophy behind corporate disclosure and the rationale for securities regulation do not generally distinguish between the issue by an entity of its own securities for fundraising purposes and the issue of other financial products by product issuers.¹⁰⁵ For example, the authors of *Ford's Principles of Corporations Law* relate Australia's securities regulation policy to the view that mandatory disclosure is in the interests of market efficiency and investor protection.¹⁰⁶ The authors of previous editions of *Securities Industry Law* considered specialised securities regulation to be necessary due to the intangible nature of securities.¹⁰⁷

FSI justified consumer protection and disclosure requirements for financial products due to their complexity and informational imbalances between product issuers and consumers.¹⁰⁸ In the American

¹⁰¹ For example, ANZ Convertible Preference Shares Prospectus (4 September 2008).

¹⁰² For example, Macquarie Convertible Preference Securities PDS, n 92.

¹⁰³ Donnan J, "Debentures, Derivatives and Managed Investment Schemes – The Characterisation and Regulation of Investment Instruments" (2002) 13 JBFLP 28.

¹⁰⁴ Cf Kingsford Smith D, "Is 'Due Diligence' Dead? Financial Services and Products Disclosure under the Corporations Act" (2004) 22 C&SLJ 128 at 129.

¹⁰⁵ For example, Llewellyn D, *The Economic Rationale for Financial Regulation*, Financial Services Authority Occasional Paper No 1 (1999); International Organization of Securities Commissions, *Objectives and Principles of Securities Regulation* (2003). A useful discussion is contained in Blair M, "The Debate over Mandatory Corporate Disclosure Rules" (1992) 15 UNSWLJ 15; Blair M and Ramsay I, "Mandatory Corporate Disclosure Rules and Securities Regulation" in Walker G, Fisse B and Ramsay I (eds), *Securities Regulation in Australia and New Zealand* (2nd ed, Lawbook Co., 1998) pp 62-78.

¹⁰⁶ Ford HAJ, Austin RP and Ramsay IM, *Ford's Principles of Corporations Law* (LexisNexis, subscription service) at [10.010].

¹⁰⁷ Baxt et al, n 4, p 2. The current edition discusses the question in similar terms: Baxt et al, n 66, pp 7-8.

¹⁰⁸ Australia, n 36, pp 186-189, 261-271.

context, and attempting to distil the essence of a security, Ronald Coffey argued that “the single most important economic characteristic which distinguished a security from the universe of other transactions” was “risk to initial investment”.¹⁰⁹

However, many of these arguments relate equally to securities as they do to derivatives (and other financial products). Both are intangible, informational imbalances exist between issuers and clients, and to the extent that there is a need for consumer protection at all, the rationale applies to both types of instrument. On the basis of these reasons alone, it is not clear why securities should be treated in a different manner to derivatives.

In their seminal work on the functional approach to regulation, Merton and Bodie identified six core functions performed by a financial system.¹¹⁰ In contrast, CASAC identified seven “functions” performed by derivatives.¹¹¹ Whether the functions identified by CASAC are economically separate functions or merely subsets of the broader functions identified by Merton and Bodie is not clear.

The economic function of securities is essentially to provide entities with a means of raising funds for their expenditure needs, for example, working capital and expansion or acquisition plans.¹¹² There are important differences between debentures and shares (both of which are “securities”), for debentures are debt instruments with fixed rights to capital and interest payments, whereas shares represent part ownership of an enterprise, with the right to share in the profit and growth of the entity. Common to both shares and debentures is that investment risks relate primarily to the profitability of the enterprise and the funds become the property of the issuer to be managed by it in its discretion.

Derivatives derive their value from an underlying subject matter such as an asset, rate or index and have essentially two main purposes, namely speculation¹¹³ and risk management,¹¹⁴ by allowing entities to hedge, transfer or adjust a financial risk or exposure, or provide cash flow or price certainty.¹¹⁵ Securities and derivatives are thus very different in their structure and economic function.

It should be noted that the traditional view of shares (one of the key forms of security) as representing a form of ownership of a company has been attacked. A number of scholars have argued that shares should be viewed merely as a capitalised dividend stream conferring the expectation to future dividends, and that modern investors conceive of shares as nothing more than an investment.¹¹⁶ Stockmarkets, in this view, function merely as mechanisms for liquidity, and not to allocate capital.¹¹⁷ If this is indeed the case,¹¹⁸ then the distinction between securities and derivatives begins to blur.

¹⁰⁹ Coffey RJ, “The Economic Realities of a ‘Security’: Is There a More Meaningful Formula?” (1967) 18 W Res L Rev 367 at 375.

¹¹⁰ Namely, clearing and settling payments, pooling resources and subdividing shares, transferring resources, providing information and dealing with incentive problems: Merton RC and Bodie Z, “A Conceptual Framework for Analyzing the Financial System” in Crane et al, n 57, pp 12-16.

¹¹¹ Namely, risk management, diversification, completing markets, achieving transactional efficiency, reducing volatility, arbitrage and speculation: Companies and Securities Advisory Committee, n 42, p 19.

¹¹² Cf Ford et al, n 106, Ch 22 (“Fundraising by issue and sale of securities”).

¹¹³ Cohen SS, “The Challenge of Derivatives” (1995) 63 Fordham L Rev 1993.

¹¹⁴ Valdez AL, “Modernizing the Regulation of the Commodity Futures Markets” (1975) 13 Harv J Leg 35 at 40.

¹¹⁵ Companies and Securities Advisory Committee, n 42, p 19.

¹¹⁶ For example, Bird H, “A Critique of the Proprietary Nature of Share Rights in Australian Publicly Listed Corporations” (1998) 22 MULR 131; Fridman S, “When Should Compulsory Acquisition of Shares be Permitted, and if so, What ought the Rules be?” in Ramsay IM (ed), *Gambotto v WCP Ltd: Its Implications for Corporate Regulation* (CCLSR, 1996); Walton R, “Gambotto v WCP Ltd: A Justified Reassertion of Minority Shareholder Rights or Unwelcome Step Back in Time” (2000) 12 AJCL 20.

¹¹⁷ Bird, n 116 at 156.

¹¹⁸ It is not a unanimous view: cf Spender P, “Compulsory Acquisition of Minority Shareholdings” (1993) 11 C&SLJ 83; Spender P, “Guns and Greenmail: Fear and Loathing After Gambotto” (1998) 22 MULR 96; McConville J, “Do Shares Constitute Property? Reconsidering a Fundamental, yet Unresolved, Question” (2005) 79 ALJ 251; Mitchell V, “Gambotto and the Rights of Minority Shareholders” (1994) 6 Bond LR 92.

Others have raised questions as to the validity of the distinction on other grounds, given that derivatives and securities are used in similar ways by investors,¹¹⁹ and that regulation of securities and futures markets serves similar purposes.¹²⁰ Added to this is the fact that the performance of a security depends as much on factors unrelated to the performance of the entity, in particular, economic conditions and market sentiment (as highlighted dramatically by recent market performance).

An attempt to distinguish between securities and derivatives was made by CASAC. Despite noting that the economic functions of securities and derivatives were increasingly converging, CASAC nevertheless recommended that the distinction be retained for technical reasons relating to clearing and settlement arrangements,¹²¹ as well as the fact that the value of securities depends heavily on the performance of the issuer, whereas a derivative's value relates to the underlying subject matter.¹²²

This reasoning may justify a higher standard of disclosure for securities, including the due diligence requirement.¹²³ But how this relates to the general philosophy of financial regulation as articulated in particular by FSI is again not clear, and it does not appear to have been adopted in the relevant CLERP policy documents.¹²⁴

It may be that there *are* cogent reasons for treating securities differently to derivatives.¹²⁵ No such analysis has been undertaken by the legislature, even though a clear distinction has been drawn between securities and derivatives.¹²⁶ A thorough functional analysis should be undertaken to evaluate whether there are good grounds for retaining the distinction, and the legislative definitions of security and derivative should reflect this analysis. The lack of such an analysis has led to a failure by the legislature to communicate a coherent policy rationale.¹²⁷

The HYENA case is an example of this point.¹²⁸ This case considered how to properly characterise High Yield Equity Notes (HYENAs), a complex structured product which was priced with reference to an underlying share and gave the issuer (Macquarie) a put option to place shares with the investor if the value of the share fell below a specified percentage. Handley DP stated that HYENAs were “just the sort of security which should [be] regulated by the prospectus regime in order to afford appropriate investor protection” because of their complex hybrid nature.¹²⁹

This seems a curious comment, given that securities are (generally) much less complex than derivatives, which are subject to the lower standard of disclosure contained in Pt 7.9, and so complexity cannot be the guide for determining the applicable regime. In fact, given the complexity of derivatives, and that as a result only experienced investors could be expected to understand and use them, the “market expectation” disclosure standard in s 1013F would seem to reduce the disclosure standard the more complex the product!

Without having undertaken a comprehensive survey, a number of disclosure documents released to the market illustrate this tension. Although practice varies widely, debenture prospectuses are often

¹¹⁹ Lawrence, n 30 at 98.

¹²⁰ Cf Latimer P, “Futures Market Regulation in Australia: What is it Trying to Achieve?” (1990) 13 UNSWLJ 370 at 372.

¹²¹ This is due to the fact that derivatives may involve long-term obligations which require margin based clearing requirements to cope with: Companies and Securities Advisory Committee, n 42, p 51.

¹²² Companies and Securities Advisory Committee, n 42, p 51.

¹²³ *Corporations Act*, s 710 – see below.

¹²⁴ Australian Treasury, *Fundraising: Capital Raising Initiatives to Build Enterprise and Employment*, Corporate Law Economic Reform Program, Proposals for Reform: Paper No 2 (AGPS, 1997); Australian Treasury, n 45.

¹²⁵ Michael Hains argues this point strongly: Hains, n 32, Ch 11.

¹²⁶ CLERP 6 stated that securities would remain subject to the prospectus regime and not be governed by the proposed uniform financial product disclosure regime: Australian Treasury, n 45, p 110.

¹²⁷ Cf Hanrahan P, “Improving the Process of Change in Australian Financial Sector Regulation” [2008] *Economic Papers* 6.

¹²⁸ *Macquarie Bank Ltd v Australian Securities and Investments Commission* (2001) 39 ACSR 508.

¹²⁹ *Macquarie Bank Ltd v Australian Securities and Investments Commission* (2001) 39 ACSR 508 at 517.

short, relatively simple documents,¹³⁰ whereas PDSs can be weighty, complex documents containing a similar level of information to what would be expected in a prospectus.¹³¹

Disclosure

It may be asked, what is the significance of the distinction between securities and derivatives, given that the FSR regime applies in relation to financial products, a concept which is defined to include both securities and derivatives? A number of areas where significant differences exist between securities and derivatives (namely disclosure, licensing and other provisions) are discussed below, beginning with a review and comparison of the applicable disclosure requirements.

The disclosure requirements for offers of securities are more exacting than the relevant test for derivatives.¹³² The Annexure below contains a detailed comparison of these provisions. The disclosure requirements for securities consist of a general disclosure test, accompanied by a limited number of specific matters that need to be disclosed. The general disclosure test provides that a prospectus must contain all the information that investors and their advisers would reasonably require to make an informed assessment of the following matters:¹³³

Offer	Matters
Offer to issue (or transfer) shares or debentures	<ul style="list-style-type: none"> • The rights and liabilities attaching to the securities. • The financial position and prospects of the body that is to issue (or issued) the shares or debentures.
Offer to grant (or transfer) a legal or equitable interest in securities or grant (or transfer) an option over securities	<ul style="list-style-type: none"> • The rights and liabilities attaching to: <ul style="list-style-type: none"> – the interest or option; – the underlying securities. • For an option – the capacity of the person making the offer to issue or deliver the underlying securities. • If the person making the offer is: <ul style="list-style-type: none"> – the body that issued or is to issue the underlying securities; or – a person who controls that body; the financial position and prospects of that body. • If s 707(3) or s 707(5) applies to the offer – the financial position and prospects of the body whose securities are offered.

There are two limitations on this general test. First, the prospectus must contain this information only to the extent to which it is reasonable for investors and their advisers to expect to find the information in the prospectus.¹³⁴ Secondly, the prospectus must contain this information “only if a person whose knowledge is relevant¹³⁵ (i) actually knows the information or (ii) in the circumstances ought reasonably to have obtained the information by making enquiries”.¹³⁶ The latter test introduces a “due diligence” requirement, where the issuer must make reasonable inquiries to ascertain all relevant information.

Under the specific disclosure requirements, a prospectus must disclose the terms and conditions of the offer, the interests and benefits of relevant persons, quotation information, expiry date and

¹³⁰ For example, Esanda Debenture Prospectus 83 (12 pages plus application form); Balanced Securities Prospectus No 9 (29 February 2008, 38 pages plus application form); Angas Securities Ltd First Ranking Debenture Stock Prospectus No 8 (4 October 2007, 20 pages plus application form).

¹³¹ For example, Brisconnections Airport Link Project PDS (24 June 2008, 184 pages plus application form); Macquarie Convertible Preference Securities PDS, n 92 (5 June 2008, 124 pages plus application form).

¹³² For convenience, only the prospectus requirements will be considered in relation to securities. Other securities disclosure documents such as offer information statements, profile statements and short-form prospectuses will not be considered, nor will the content rules for continuously quoted securities (s 713), or the exclusion for rights issues (s 708AA).

¹³³ *Corporations Act*, s 710.

¹³⁴ *Corporations Act*, s 710(1)(a).

¹³⁵ As set out in *Corporations Act*, s 710(3).

¹³⁶ *Corporations Act*, s 710(1)(b).

lodgment.¹³⁷ A prospectus must be lodged with the Australian Securities and Investments Commission (ASIC) in all cases,¹³⁸ and be authorised by all the directors of the body.¹³⁹ ASIC has introduced additional requirements for debentures.¹⁴⁰

In contrast, PDSs for derivatives are required to comply with a long list of specific disclosures, supplemented by a general test. A PDS must contain information about the issuer, benefits, risks, fees, expenses, charges, commissions, characteristics and features of the product, dispute resolution, tax implications and cooling off.¹⁴¹ The supplemental test requires any information that might reasonably be expected to have a material influence on a retail client's decision as to whether to acquire the product to be disclosed.¹⁴²

Two important limitations exist for the PDS disclosure requirements. First, information is not required if it would not be reasonable for a retail client to expect to find the information.¹⁴³ Secondly, only information that is actually known by the issuer is required to be disclosed,¹⁴⁴ which means that due diligence inquiries are not necessary for the issue of a PDS, although due diligence is advisable for liability defence reasons.¹⁴⁵

There is no express requirement for a PDS to be signed by the issuer or seller or its directors. A PDS for a derivative is not required to be lodged, but an in-use notice must be lodged with ASIC.¹⁴⁶ PDSs for derivatives are also required to disclose information on environmental, social or ethical considerations.¹⁴⁷ Both prospectuses and PDSs must be worded in a clear, concise and effective manner¹⁴⁸ and be dated.¹⁴⁹

There are thus significant differences between the disclosure requirements for securities and derivatives. In particular, Ch 6D requires securities issuers to disclose all information necessary to make an informed assessment of the terms of the securities and the issuer's financial position and prospects, including information that is not known but ought reasonably to be known. The disclosure requirements for derivatives are limited to information that is actually known by the issuer. The distinction between securities and derivatives remains very important for this reason.

Licensing

The issue by a body (other than a body which carries on an investment business) of its own securities is taken not to be dealing in a financial product, and accordingly, a financial services licence is not required.¹⁵⁰ As a result, the majority of the licensing and conduct provisions contained in Ch 7 do not apply. Derivatives are not covered by this exemption.

¹³⁷ *Corporations Act*, s 711.

¹³⁸ *Corporations Act*, s 718.

¹³⁹ *Corporations Act*, s 720.

¹⁴⁰ ASIC, *Debentures – Improving Disclosure for Retail Investors*, Regulatory Guide 69 (2008); ASIC, *Debenture Prospectuses*, Regulatory Guide 155 (2000).

¹⁴¹ Baxt et al, n 66 at [6.42].

¹⁴² *Corporations Act*, s 1013E.

¹⁴³ *Corporations Act*, s 1013F.

¹⁴⁴ *Corporations Act*, s 1013C(2).

¹⁴⁵ *Corporations Act*, ss 1021E(4), 1022B(7).

¹⁴⁶ *Corporations Act*, s 1015D.

¹⁴⁷ *Corporations Act*, s 1013DA. See ASIC, *Section 1013DA Disclosure Guidelines*, Regulatory Guide 65 (2003); Donnan J, "Regulating Ethical Investment: Disclosure under the Financial Services Reform Act" (2002) 13 JBFLP 155.

¹⁴⁸ *Corporations Act*, ss 715A, 1013C(3).

¹⁴⁹ *Corporations Act*, ss 716, 1013G.

¹⁵⁰ *Corporations Act*, s 766C(4).

A product issuer who issues derivatives in the course of conducting a financial services business is dealing in financial products¹⁵¹ and will need to obtain a financial services licence.¹⁵² If the instrument issued by the issuer is characterised as a security, then the most likely position is that the issuer would require a licence.¹⁵³

In this regard, an interesting question arises as to the interpretation of the own-securities exemption. Where an unrelated product issuer issues options or warrants in respect of the securities of another entity, the product would itself be a security, and so could conceivably be characterised as “securities of that entity” within the meaning of s 766C(4)(d), removing the need for the product issuer to be licensed. The practical scope of this interpretation is likely to be minimal given ASIC’s broad powers,¹⁵⁴ however, it yet again illustrates the lack of a functional approach in the definition of security.

The requirement to be licensed relates primarily to two factors: the nature of the product being issued, and the character of the business conducted by the issuer. Characterising an instrument as either a security or derivative is not determinative of the question as to whether a licence is required for a product issuer, however, it is an important step in that process.

Significant obligations flow from the need to obtain a licence, in particular complying with the onerous general obligations,¹⁵⁵ which include acting efficiently, honestly and fairly,¹⁵⁶ requirements relating to having arrangements for managing conflicts of interest,¹⁵⁷ supervising representatives, maintaining adequate resources¹⁵⁸ and organisational competence,¹⁵⁹ and maintaining compliance and risk management systems.¹⁶⁰ Other requirements include entering into dispute resolution and compensation arrangements for retail clients,¹⁶¹ information and breach reporting,¹⁶² the financial services disclosure provisions of Pt 7.7, and the conduct provisions of Pt 7.8, including dealing with client money and property,¹⁶³ insurance,¹⁶⁴ financial reporting and audit,¹⁶⁵ and the miscellaneous conduct provisions in Pt 7.8, Div 7.

Accordingly, the distinction between securities and derivatives has important ramifications for licensing. It also has significance for the scope of a licensee’s licence authorisation conditions. A licence must specify the particular financial products for which the licensee is authorised,¹⁶⁶ and a failure to properly characterise a product may lead to a breach of the financial services laws if a licensee is not properly authorised for its intended activities.

¹⁵¹ *Corporations Act*, s 766C(1)(b).

¹⁵² *Corporations Act*, s 911A.

¹⁵³ Again, provided that it was in the course of a financial services business.

¹⁵⁴ See Baxt et al, n 66, Ch 2.

¹⁵⁵ *Corporations Act*, s 912A.

¹⁵⁶ See Latimer P, “Providing Financial Services ‘Efficiently, Honestly and Fairly’” (2006) 24 C&SLJ 382.

¹⁵⁷ See *Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Ltd (No 4)* (2007) 160 FCR 35. ASIC’s view is set out in *Licensing: Managing Conflicts of Interest*, Regulatory Guide 181 (2004).

¹⁵⁸ ASIC, *Licensing: Financial Requirements*, Regulatory Guide 166 (reissued 2007).

¹⁵⁹ ASIC, *Licensing: Organisational Competence*, Regulatory Guide 105 (2007).

¹⁶⁰ ASIC, *Licensing: Meeting the General Obligations*, Regulatory Guide 104 (2007).

¹⁶¹ *Corporations Act*, ss 912A(1)(g), 912A(2), 912B; ASIC, *Licensing: Internal and External Dispute Resolution*, Regulatory Guide 165 (2001).

¹⁶² *Corporations Act*, ss 912C-912E; ASIC, *Breach Reporting by AFS Licensees*, Regulatory Guide 78 (2006).

¹⁶³ *Corporations Act*, Pt 7.8, Divs 2-3 (ss 981A-984B).

¹⁶⁴ *Corporations Act*, Pt 7.8, Div 4 (ss 985A-985C).

¹⁶⁵ *Corporations Act*, Pt 7.8, Div 6 (ss 987A-990L).

¹⁶⁶ *Corporations Act*, s 914A(6), (7); ASIC, *AFS Licensing Kit: Part 1 – Applying for and Varying an AFS Licence*, Regulatory Guide 1 (2008); ASIC, *AFS Licensing Kit: Part 2 – Preparing your AFS Licence Application*, Regulatory Guide 2 (2008); ASIC, *AFS Licensing Kit: Part 3 – Preparing your Additional Proofs*, Regulatory Guide 3 (2008).

Other aspects of regulation

A number of other key provisions of Ch 7 that are applicable to securities and derivatives are examined below.

Market misconduct

The market manipulation, false trading and market rigging and other associated provisions in Pt 7.10, Div 2 apply in relation to financial products generally, which includes both securities and derivatives. The insider trading offences apply to both securities and derivatives.¹⁶⁷ The short selling provisions apply in relation to “s 1020B products” which includes both securities¹⁶⁸ and, by virtue of the Regulations, derivatives.¹⁶⁹ Accordingly, the distinction makes no difference for the purposes of these provisions.

It is doubtful that this approach is appropriate in all cases. For example, Donnan has questioned the relevance of the prohibition on insider trading for over-the-counter (OTC) derivatives.¹⁷⁰

Advertising and publicity

Advertising of securities is regulated by s 734, and s 1018A regulates advertising of other financial products. Prior to issuance of the relevant disclosure document, limited advertising of securities is permitted – only a “tombstone statement” setting out minimal information.¹⁷¹ However, advertising of other financial products before they are made available is permissible provided a disclaimer is included in the prescribed form.¹⁷²

After the products and the disclosure document are available, advertising of both securities and other financial products is regulated in the same manner, being permissible provided a required disclaimer is included,¹⁷³ although minor differences exist in the prohibitions and the wording of the required disclaimers. Exceptions apply for both classes of products, in largely identical terms. The advertising provisions applicable to securities are thus more stringent than those applicable to derivatives.

Hawking

Hawking of securities is regulated by s 736, and s 992A regulates hawking of other financial products.¹⁷⁴ The major differences in the hawking prohibitions applicable to securities and derivatives are as follows. First, securities must not be offered for issue or sale as a result of an unsolicited meeting or telephone call.¹⁷⁵ Other financial products must not be offered for issue or sale as a result of an unsolicited meeting,¹⁷⁶ but may be offered following an unsolicited telephone call provided certain requirements are met.¹⁷⁷ Secondly, and significantly, the prohibition on hawking securities is an offence of strict liability, but the hawking of other financial products (including derivatives) is not. Finally, a number of exceptions apply to unsolicited offers of securities which do not apply to other products,¹⁷⁸ which has the odd result that the prohibition on securities hawking is more stringent in some ways but less stringent in others.

¹⁶⁷ *Corporations Act*, s 1042A (definition of “Division 3 financial products”).

¹⁶⁸ *Corporations Act*, s 1020B(1)(a).

¹⁶⁹ By virtue of *Corporations Regulations*, reg 7.9.80B.

¹⁷⁰ Donnan J, “Insider Trading and OTC Derivatives under the Financial Services Reform Act” (2003) 14 JBFLP 32.

¹⁷¹ *Corporations Act*, s 734(5).

¹⁷² *Corporations Act*, s 1018A(2).

¹⁷³ *Corporations Act*, s 1018A(2).

¹⁷⁴ Other than managed investment products, which are covered by s 992AA of the *Corporations Act*.

¹⁷⁵ *Corporations Act*, s 736(1).

¹⁷⁶ *Corporations Act*, s 992A(1).

¹⁷⁷ *Corporations Act*, s 992A(3).

¹⁷⁸ *Corporations Act*, s 736(2).

Continuous disclosure

The continuous disclosure provisions contained in Ch 6CA apply where an entity is a “disclosing entity”.¹⁷⁹ “Disclosing entity” is defined as an entity whose securities are “ED securities”,¹⁸⁰ which includes securities issued pursuant to a disclosure document under Ch 6D where after the issue there are 100 or more holders of securities in that class.¹⁸¹ Accordingly, if a product is a security as opposed to a derivative, and the other tests are satisfied, the continuous disclosure obligations may be triggered.

Liability and offences

The Annexure below contains a more detailed comparison of the liability and offence provisions. These provisions are generally consistent, although some significant differences exist. In relation to securities, disclosure is defective if there is a misleading statement, an omission of material required to be included, or a new circumstance has arisen requiring further disclosure. It is an offence to offer securities under a defective disclosure document if the defect is “materially adverse from the point of view of an investor”.¹⁸²

In relation to derivatives, disclosure is defective if there is a misleading statement or an omission of material required to be included, and the defect is “materially adverse from the point of view of a reasonable person” considering whether to acquire the product.¹⁸³ It is an offence for a preparer of a defective PDS to give the document knowing it is defective¹⁸⁴ or giving a defective PDS whether or not the person knows it is defective.¹⁸⁵

It is an offence to offer securities without a disclosure document.¹⁸⁶ It is an offence to fail to give a PDS when required.¹⁸⁷ For both regimes, a person who suffers loss or damage due to defective disclosure may recover the amount of the loss or damage,¹⁸⁸ although in relation to PDSs, it is not necessary that the defect be materially adverse (unlike for the criminal liability provisions).¹⁸⁹ This appears to be a lower standard for civil liability for derivatives.

Both regimes have a due diligence defence, although worded differently. There is a due diligence defence to civil and criminal liability where the person made reasonable inquiries in the circumstances (for offers of securities),¹⁹⁰ and where the person took reasonable steps to ensure the PDS would not be defective (for derivatives).¹⁹¹ There is also a reasonable reliance defence to civil and criminal liability for securities, where the person places reasonable reliance upon information given by another person, which is not available for derivatives.¹⁹²

One interesting aspect of the financial services laws is that there is a raft of offences which apply in relation to financial products including derivatives, but not securities. These include the following:

- It is an offence for a regulated person other than a preparer to give a PDS knowing it to be defective (s 1021F).

¹⁷⁹ *Corporations Act*, s 675. See also s 674 in relation to listed entities.

¹⁸⁰ *Corporations Act*, s 111AC. ED Securities stands for “enhanced disclosure securities” (s 111AD).

¹⁸¹ *Corporations Act*, s 111AF.

¹⁸² *Corporations Act*, s 728.

¹⁸³ *Corporations Act*, s 1021B(1).

¹⁸⁴ *Corporations Act*, s 1021D.

¹⁸⁵ *Corporations Act*, s 1021E; see also s 1021H.

¹⁸⁶ *Corporations Act*, s 727(1).

¹⁸⁷ *Corporations Act*, s 1021C.

¹⁸⁸ *Corporations Act*, ss 729, 1022B(2).

¹⁸⁹ Baxt et al, n 66, p 281.

¹⁹⁰ *Corporations Act*, s 731.

¹⁹¹ *Corporations Act*, ss 1021E(4), 1022B(7).

¹⁹² *Corporations Act*, s 733.

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- It is an offence to fail to comply with certain technical requirements, including the title and date of the PDS (s 1021H).
- It is an offence to fail to take steps to prevent the distribution of a defective PDS (s 1021J).
- It is an offence to alter a PDS so that it becomes defective or more defective (s 1021K).
- It is an offence to give or fail to withdraw a defective statement (s 1021L).
- It is an offence to fail to provide additional information (s 1021N).

Accordingly, it appears that while the disclosure requirements for offers of securities are more exacting than those applicable to derivatives, the offence and liability provisions for derivatives are more extensive than for securities.

Conclusion

It is commonly thought that the introduction of the generic term “financial product” means that the distinction between securities and derivatives is now of little consequence, save perhaps for disclosure requirements. This discussion shows that the law applying to derivatives and securities is a complex and inconsistent patchwork of regulation, and the distinction between derivatives and securities has very real implications in a number of key areas.

For example, for a product issuer to issue warrants or exchange-traded options, it would need to be authorised to deal in securities but must comply with disclosure requirements under the PDS regime as if it was a derivative. A financial services licensee can hawk listed securities but not exchange-traded derivatives. Although securities are normally thought to justify a higher standard of regulation, and have higher disclosure requirements, the liability and offence provisions are stricter with respect to derivatives.

The *Corporations Act* thus treats derivatives and securities as functionally equivalent for some purposes but not for others. In some cases, securities are regulated more stringently, however in other cases, derivatives are subject to higher levels of regulation.

Appropriate market forum

The critical issue driving the LEPO litigation was whether LEPOs were futures contracts or securities, and thus which was the appropriate market forum to conduct a market for them. FSR has replaced the previous separate licensing regimes for securities markets and futures markets with one which permits the authorisation of “financial markets”, defined (broadly) to mean a facility where financial products are traded.¹⁹³ As noted, “financial product” includes both securities and derivatives.¹⁹⁴

Market operators are not granted a generic licence to conduct a market in respect of financial products generally, but are authorised in respect of certain classes of financial products.¹⁹⁵ An operator can conduct a market for numerous classes of products concurrently, but would need to be specifically authorised for each class of financial product.

Although clearly superior to the prior position, this reintroduces the significance of the definitions of security and derivative. It is important to determine if a particular instrument is a derivative or a security and whether the market operator has the necessary authorisation in respect of such products. For example, some market operators are authorised to operate markets for securities and not derivatives,¹⁹⁶ and others are authorised to operate markets for derivatives and not securities. This restricts the class of products that can be traded, and accordingly, the distinction between securities and derivatives remains important.

CONCLUSION

While FSR has considerably improved the position, problems still exist. Uncertainty remains as to the scope of the definitions. These defects are significant due to the important differences that exist in the

¹⁹³ *Corporations Act*, s 767A.

¹⁹⁴ *Corporations Act*, s 764A.

¹⁹⁵ *Corporations Act*, s 796A(4)(b); *Corporations Regulations*, reg 7.2.11(e).

¹⁹⁶ For example, Australia Pacific Exchange Ltd, Stock Exchange of Newcastle Ltd and Bendigo Stock Exchange Ltd.

treatment of securities and derivatives. It is not clear that there is a coherent rationale for these distinctions, as they are treated as functionally equivalent for some purposes and different for other purposes. Finally, the definitions continue to be based on legal characteristics and the rhetoric of functional regulation has not truly been implemented.

ANNEXURE: COMPARISON TABLES

The Annexure provides a series of tables summarising the major regulatory provisions applicable to securities and derivatives for the purposes of comparison.

General

The following table summarises the major general provisions:

Matter	Securities	Derivatives
Licensing and licensee obligations	Issue of own securities by body: licence not required.	Issue of derivatives: licence required. ¹⁹⁷
	Issue of securities by other person: licence required. ¹⁹⁸	
Special requirements	Debentures: Ch 2L applies.	Not applicable.
Trading on financial market	Specific authorisation required to conduct financial market in securities (s 796A(4)(b)).	Specific authorisation required to conduct financial market in derivatives (s 796A(4)(b)).
Application money	Must be held in trust prior to issue of securities or return of money (s 722(1)).	Must be paid into prescribed special purpose account and is taken to be held in trust (s 1017E).
	If application money needs to be returned, it needs to be done as soon as practicable (s 722(2)) but otherwise no further detailed requirements apply.	Further detailed requirements apply relating to conditions for withdrawal of funds, obligations of the product provider and timing (s 1017E).
	Offence of strict liability (s 722(3)).	No offence of strict liability.
Transaction confirmation	Transaction confirmation requirements apply (ss 1010A, 1017F).	Transaction confirmation requirements apply (s 1017F).
Cooling-off	Not available for securities.	Not available for derivatives.
Hawking	Must not be offered as a result of an unsolicited meeting or telephone call (s 736).	Must not be offered because of an unsolicited meeting but may be offered because of an unsolicited telephone call provided requirements are met (s 992A).
	Offence of strict liability (s 736(1B)).	No offence of strict liability.
	Exceptions apply (s 736(2)).	No exceptions apply.
Advertising	Pre-issuance of disclosure document: "tombstone statement" only permitted (s 734(5)).	Pre-issuance of PDS: advertising permitted but disclaimer must be included (s 1018A(2)).
	Post-issuance of disclosure document: advertising permitted but disclaimer must be included (s 734(6)).	Post-issuance of PDS: advertising permitted but disclaimer must be included (s 1018A(1)).
	Exceptions apply (s 734(7)).	Exceptions apply (s 1018A(4)).

¹⁹⁷ If issued in the course of a financial services business.

¹⁹⁸ If issued in the course of a financial services business.

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Matter	Securities	Derivatives
	Offence of strict liability (s 734(2B)).	No offence of strict liability.
Unsolicited offers to purchase (Pt 7.9, Div 5A)	Applies in respect of securities.	Applies in respect of derivatives.
Pt 7.10, Div 2 offences (market misconduct)	Applies to financial products generally, including securities and derivatives.	Applies to financial products generally, including securities and derivatives.
Insider trading	Insider trading prohibited in respect of securities.	Insider trading prohibited in respect of derivatives.
Short selling	Provisions apply in respect of securities (s 1020B).	Provisions apply in respect of derivatives (reg 7.9.80B).
Continuous disclosure	Applies where securities are "ED Securities".	Not applicable.

Disclosure

The following table summarises the disclosure requirements:

Matter	Securities	Derivatives (including warrants)
Applicable disclosure regime	Issue of securities: Ch 6D.	Pt 7.9.
	Issue of warrant: Pt 7.9 (reg 7.9.07A).	
Disclosure test	All information that investors would reasonably require to make an informed assessment of: <ul style="list-style-type: none"> the rights and liabilities attaching to the securities offered; the financial position and prospects of the body that is to issue (or issued) the shares or debentures (s 710). 	Any information that might reasonably be expected to have a material influence on a retail client's decision whether to acquire the product (s 1013E).
	Must be reasonable for investors to expect to find the information.	Not required if not reasonable for retail client to expect to find the information (s 1013F).
	Information must be actually known or ought reasonably to be known (s 710(1)).	Information must be actually known (s 1013C(2)).
Specific disclosures	Disclosure of terms and conditions of offer, interests and benefits, quotation information, expiry date and lodgment (s 711). Additional requirements for debentures. ¹⁹⁹	Information about the issuer, benefits, risks, fees, expenses, charges, commissions, characteristics and features of the product, dispute resolution, tax implications, cooling off. ²⁰⁰
Presentation	Clear, concise and effective (s 715A), dated (s 716).	Clear, concise and effective (s 1013C(3)), dated (s 1013G).
Environmental, social, ethical considerations	Disclosure not required.	Disclosure not required where the derivative has an investment component (s 1013DA). ²⁰¹
Due diligence	Required (s 710(1)).	Not required (s 1013C(2)) but advisable for liability reasons (ss 1021E(4), 1022B(7)).

¹⁹⁹ Regulatory Guide 69, n 140; Regulatory Guide 155, n 140.

²⁰⁰ Baxt et al, n 66 at [6.42].

²⁰¹ See Regulatory Guide 65, n 147; Donnan, n 147.

Matter	Securities	Derivatives (including warrants)
Authorisation	Every director of the issuer body needs to consent (s 720). ²⁰²	No express requirement for a PDS to be signed by the issuer or seller or its directors. ²⁰³
Consents	Required from every person making a statement in prospectus (s 716). ²⁰⁴ Normally obtained from directors, advisors etc.	Required from every person making a statement in a PDS (s 1013K). ²⁰⁵
Lodgment with ASIC	Required in all cases (s 718).	Not required to be lodged, but in-use notice to be lodged with ASIC (s 1015D).
Application form	Application form must accompany prospectus (s 727(2)). Securities may only be issued or transferred in response to an application form (s 723(1)).	Not applicable (s 1016A).
Exposure period	7-day exposure period applies (s 727(3)).	Not applicable.
Expiry	13 months after date of prospectus (s 711(6)). Offering securities under an expired prospectus is a strict liability offence (s 725).	No expiry but must contain up-to-date information (s 1012J). ²⁰⁶
Conditions	Conditions stipulated in prospectus must be complied with prior to issue of securities (s 723).	Conditions stipulated in PDS must be complied with prior to issue of derivatives (ss 1016C, 1016D).
	Strict liability offence (s 723(4)).	No strict liability offence.
ASIC power	ASIC can make stop order if prospectus is defective (s 728) or is not worded in a clear, concise and effective manner, or advertisement is defective (s 739).	ASIC can make stop order if PDS is defective, or is not worded in a clear, concise and effective manner, or advertisement is defective, or issuer does not have dispute resolution scheme (s 1020E).

Liability and offence provisions

The following table summarises the offence and liability provisions:

Matter	Securities	Derivatives
Defective disclosure	Disclosure is defective if there is a misleading or deceptive statement, a material omission from the document, or new information arises that needs to be disclosed (s 728(1)).	Disclosure is defective if there is a misleading or deceptive statement, or certain information is omitted, and the statement or omission is materially adverse (s 1021B(1)).
Body does not exist	Offence to offer securities in a body that does not exist (s 726).	No equivalent.
Offer without disclosure document	Offence to offer securities without disclosure document (s 727(1)).	Offence to fail to give PDS ²⁰⁷ when required (s 1021C).

²⁰² Separate requirements apply in respect of sale offers: *Corporations Act*, s 720, items 2-4.

²⁰³ Baxt et al, n 66 at [6.41].

²⁰⁴ Subject to ASIC Class Order relief.

²⁰⁵ Subject to ASIC Class Order relief.

²⁰⁶ See also ASIC Class Order 00/237.

²⁰⁷ For convenience, this is taken to mean “disclosure document or statement” as defined in s 1021B for the purposes of this table.

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Matter	Securities	Derivatives
Where disclosure defective	An offer must not proceed where disclosure is defective (s 728(1)).	Offence to knowingly provide a defective PDS (s 1021D).
	Offence to offer securities where defect exists which is materially adverse (s 728(3)).	Offence to provide a defective PDS (s 1021E).
Civil liability	A person who suffers loss or damage due to contravention of s 728 may recover the amount of the loss or damage (s 729).	A person who suffers loss or damage due to defective PDS may recover the amount of the loss or damage (s 1022B(2)).
Other offences	Not applicable.	Offence for regulated person other than preparer giving PDS knowing it to be defective (s 1021F).
		Offence for licensee to fail to ensure representatives give required documents (s 1021G).
		Offence to fail to comply with certain requirements, including the requirement to have a title and be dated (s 1021H).
		Offence to give document not prepared by the appropriate person (s 1021I).
		Failure to take steps to prevent the distribution of defective PDS (s 1021J).
		Offence to alter PDS so that it becomes defective or more defective (s 1021K).
		Giving or failing to withdraw defective statement (s 1021L).
		Failure to comply with in-use notice provisions and keep and provide copies of PDS (s 1021M).
		Failure to provide additional information (s 1021N).
Failure to pay application money into designated account (s 1021O).		
General prohibitions on misleading conduct	General prohibitions do not apply (s 1041H(3)(a), ASIC Act s 12DA(1A)).	General prohibitions do not apply (s 1041H(3)(c), ASIC Act s 12DA(1A)).
Information offences (ss 1041E-1041G) ²⁰⁸	Information offences apply to securities.	Information offences apply to derivatives.
Defences	Due diligence defence to civil and criminal liability where reasonable inquiries made (s 731).	Due diligence defence to civil and criminal liability where reasonable steps taken (ss 1021E(4), 1022B(7)).
	Reasonable reliance defence to civil and criminal liability (s 733).	Not applicable.

²⁰⁸ Namely making false and misleading statements (s 1041E), inducing persons to deal in financial products on a misleading basis (s 1041F), and engaging in dishonest conduct (s 1041G).