

# COVID-19: PRESSURE POINTS: FINANCIAL PRODUCT DISCLOSURE IN THE AGE OF COVID-19 (AUSTRALIA)

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Legal Briefings - By **Michael Vrisakis, Tamanna Islam and Sky Kim**

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This article is the first in a series by our financial services team which will explore the practical implications of COVID-19 on the financial services industry and our clients' businesses.

In particular, this series is part of our Financial Services' "Integrated Legal Enhanced Assisted Productivity (I-LEAP) Initiative" which examines various areas of business activity where we feel legal solutions can result in productivity gains and efficiencies.

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The way we live, work and socialise have not been the only changes owing to the COVID-19 pandemic - the Government has also been led to introduce a variety of measures affecting the financial services industry, including the reduction of default minimum withdrawal rates for pensions (for 2019-20 and 2020-21) and allowing for temporary early release of superannuation.

The economic impact caused by the pandemic also means that many sections in a product disclosure statement (**PDS**) may need to be updated, including significant risks, liquidity, distribution policy, asset allocations and valuations, underlying assumptions and fees and costs. This poses important questions for financial product issuers, who have ongoing obligations under the *Corporations Act 2001* (Cth) (**Corporations Act**) to ensure that their PDSs are kept up to date and to notify holders of financial products of material changes and significant events.

Product issuers who are required to, or wish to, update their PDSs in a cost-effective and expeditious manner, are provided some useful practical relief under the *ASIC Corporations (Updated Product Disclosure Statements) Instrument 2016/1055 (Instrument)*. An important regulatory marker to pay attention to is the key restriction on using the Instrument, namely that the updated information cannot be materially adverse. We explore this concept in further detail below as well as what types of changes need to be disclosed and what disclosure options might be available to product issuers, including if and when the Instrument could be relied upon. Greater flexibility exists, in our opinion, to add product changes and deal with COVID-related operational changes than might have been thought to be the case.

## **WHAT TYPES OF CHANGES NEED TO BE DISCLOSED?**

As a starting point, section 1012J of the Corporations Act provides that the information in a PDS must be up to date at the time it is given. A PDS must also not otherwise be “defective” under the Corporations Act.

Updated information may relate to any aspect of the PDS or the product, whether materially adverse or not. A supplementary product disclosure statement (**SPDS**) containing updated information may be given with a PDS that is out of date (other than in the case of a short-form PDS). Alternatively, the product issuer may issue a new PDS (ie a PDS roll), although this clearly has cost, time, operational and other logistical implications.

Any changes that impact the significant characteristics and features of a financial product, the rights, terms and conditions and obligations attaching to the product or any other information relevant to the acquisition decision must be disclosed via an update to the PDS to prevent the PDS from being out of date or defective.

It should be noted that it would not be necessary to update a PDS in relation to information which, as contemplated by section 1013F of the Corporations Act, is not required to be included in the PDS because it would not be reasonable for a retail client to expect to find this information in the PDS. An example might be the new superannuation access scheme which because of Government, media and regulatory publicity, may not be information that a retail client would reasonably expect to find in the PDS.

## **WHAT CAN BE DISCLOSED WITHOUT A SPDS OR A NEW PDS?**

A SPDS or a new PDS containing updated information may be used to prevent a PDS from becoming non-compliant on the basis of the PDS being outdated or defective. However, not all disclosures will require a SPDS or a new PDS, as the Instrument permits any updates that do not include “materially adverse” information may be disclosed elsewhere, subject to the following conditions being met:

- The PDS was up to date at the time when it was prepared;
- the updated information in relation to the PDS does not include any materially adverse information;
- The issuer has taken reasonable steps to ensure that the PDS clearly and prominently explained that information that is not materially adverse information is subject to change from time to time and may be updated by means described in the PDS, explained how that updated information can be found out at any time, and stated that a paper copy of any updated information will be given, or an electronic copy made available, to a person without charge on request;
- The issuer has taken reasonable steps to establish and maintain means by which a person may find out any updated information, being means that are simple and involve no charge and little inconvenience to the person, having regard to the kinds of persons likely to consider acquiring the financial product to which the PDS relates; and
- The issuer has taken reasonable steps to make available any updated information as soon as practicable to each regulated person to whom the PDS has been provided for further distribution and to cause a copy of any updated information to be kept for 7 years after it is prepared.

The effect of the above is that even if the updated information would ordinarily require the issue of a new PDS or a SPDS, this would not be required as long as the information is not materially adverse to the holder, the issuer met the other conditions of the Instrument, including by establishing other simple means by which the holders can access any updated information (such as website disclosure).

From a practical perspective, it is important to remember that the Instrument may only be used for PDSs that become out of date. The Instrument relief cannot be used in respect of defective PDSs as any changes to correct a defective PDS would be materially adverse, as per the definition in section 1021B of the Corporations Act.

Therefore, there must be a change in order for the Instrument to be used. The Instrument is ideally suited to update a PDS for non-materially adverse COVID-19 changes instituted by the product issuer to the product itself or an associated administrative process. In addition, it can also be used for other changes affecting the information in the PDS which are not made by the product issuer, such as regulatory changes (including during COVID-19).

It is always important to bear in mind that the Instrument cannot be used in all cases of an out of date PDS. Where a PDS has become out of date by reason of a materially adverse change (ie the PDS becomes defective), the Instrument cannot be used because, as noted above, the information has become materially adverse and the central condition in the Instrument is therefore not satisfied.

# WHAT CONSTITUTES “MATERIALLY ADVERSE” INFORMATION?

There are several ways in which additions to or other modifications to information contained in a PDS could be materially adverse. For example, adding restrictions to withdrawal criteria in superannuation, or increasing the frequency of indexation of fees would constitute materially adverse information. The concept of “materially adverse” information is defined in the Instrument as:

“information of a kind the inclusion of which in, or the omission of which from, a Statement would render the Statement defective within the meaning of section 1021B of the Act”.

This concept of “defective” is, in relation to a disclosure document or statement, defined as:

- a. there is a misleading or deceptive statement in the disclosure document or statement; or
- b. if it is a PDS — there is an omission from the PDS of material required by section 1013C, other than material required by section 1013B or 1013G (**content requirements**); or
- c. if it is a SPDS that is given for the purposes of section 1014E—there is an omission from the SPDS of material required by that section; or
- d. if it is information required by paragraph 1012G(3)(a)—there is an omission from the information of material required by that paragraph;

being a statement, or an omission, that is or would be materially adverse from the point of view of a reasonable person considering whether to proceed to acquire the financial product concerned.

The content requirements include that a PDS must contain information:

- about the significant characteristics and features of the product, or of the rights, terms and conditions and obligations attaching to the product (section 1013D(1)(f) of the Corporations Act); and
- that might reasonably be expected to have a material influence on the decision of a reasonable person, as a retail client about whether to acquire the product (section 1013E of the Corporations Act).

Importantly, the concept of “materially adverse” requires the information to be both material and adverse from the perspective of a reasonable person deciding whether to acquire the product. It is not enough that the information is merely “material”, as required under section 1013E of the Corporations Act.

## **WHAT CHANGES CAN THE INSTRUMENT BE USED FOR?**

A key issue relevant to relying on the Instrument to update the contents of a PDS, particularly in the current climate, is just exactly what type of content can be added to, varied or replaced in the PDS.

At first blush, this may seem a trite issue. The reality, however, is a little different. Section 1012J simply stipulates that the information in the PDS must be up to date as at the time it is given. This indicates that changes to any information which is in the current PDS must be updated in the PDS at the time it is given to the retail client. This contextualisation requires one to focus on the types of information which are included in the PDS.

The Corporations Act very clearly states that a PDS contains, or can contain, two categories of information, as follows:

- statements and information required by the Corporations Act (ie Division 2 of Part 7.9). Information required to be included in the PDS fits into two sub-categories. The first is specific information required by section 1013D. The second is any other information which might be expected to have a material influence on the decision of a reasonable person, as a retail client about whether to acquire the financial product, as required by section 1013E; and
- any other information which may be included in the PDS but which is not required.

Although differing legal views have been expressed, it remains our unequivocal view that by reason of section 1013C, the Instrument can be used not only to update information required by the Corporations Act (ie as referred to in section 1013C(1)(a)) but to update any other information that has been included voluntarily (ie as referred to in section 1013C(1)(b)).

The implications of this legal position are significant for product issuers who wish to rely on the Instrument to deal with COVID-19 related changes. This is because they will be able to rely on the Instrument to update information in the PDS:

- where the product features or other information required by section 1013D changes such as information about:
  - fees and costs;
  - significant characteristics or features of the product or of the rights, terms and conditions and obligations attaching to the product; or
  - significant risks associated with the product,subject to the materially adverse condition; and
  
- any other changes to the information contained in the PDS. This is very broad, as it captures voluntary disclosure as flagged above.

The use of the word “update” suggests that the content is being changed which could mean additions, subtractions or modifications to the existing information in the PDS.

To understand how wide the use of the Instrument would be, it is useful to identify some practical examples:

- **Scenario 1:** A superannuation trustee lowers the minimum investment amount for its superannuation product due to COVID-19

The trustee may rely on the Instrument and update this information via its website, as the information is unlikely to be materially adverse to a prospective member.

- **Scenario 2:** A superannuation trustee issues pensions-based investment products and must disclose the reduction of default withdrawal rates for pensions by 50% for 2019-20 and 2020-21 as a result of COVID-19

The trustee will be able to successfully rely on the Instrument on the basis that the information update is unlikely to be materially adverse to prospective pensioners and instead, is a factual update of statutory changes.

- **Scenario 3:** The responsible entity of a managed investment scheme must change its asset allocations disclosed in its PDS due to changed economic conditions as a result of COVID-19

It is likely that the responsible entity will need to make the change through an updated PDS or a SPDS, as the changing asset allocations may constitute materially adverse information.

- **Scenario 4:** An insurer is increasing its fees and charges due to changed economic conditions as a result of COVID-19

The insurer will need to issue an updated PDS or a SPDS. This is because an increase in fees and charges is materially adverse information which means the Instrument will not apply.

- **Scenario 5:** A superannuation trustee wishes to disclose additional withdrawal options available to members, such as introduction of financial hardship withdrawals during COVID-19

The trustee may rely on the Instrument and update this information via its website, as the information is unlikely to be materially adverse to a prospective member.

Beyond these specific examples, there are a range of disclosure situations in which the Instrument can be relied upon (which in addition to the specific examples above assume that the Instrument conditions are satisfied), such as:

- Certain changes to product features: This could cover switching restrictions, withdrawal restrictions, changes to indexation and eligibility criteria;
- Information relating to regulatory matters: This could cover changes to the way the product is legally regulated, for example, changes to legislated withdrawal amounts; and
- Information relating to operational matters: This type of information will often fall into the reasonably expected information (see discussion on section 1013E above) or information voluntarily disclosed (see discussion relating to section 1013C(2) above). This can include matters such as:
  - application or redemption processes;
  - unit pricing methodology and asset valuations; or
  - hardship withdrawal requirements.

## **SIGNIFICANT EVENT NOTICES**

Section 1017B of Corporations Act requires ongoing disclosure of material changes and significant events, as well as a significant event notice (**SEN**) where there is any material change to a matter or significant event that affects a matter that would have been required to be specified in a PDS for the financial product. This updating obligation does not apply to widely held managed investment schemes where 100 or more people hold units in a class where the offers of those units required a PDS (where the units are 'ED securities').

If the change is an increase in fees or charges, then the SEN must be issued 30 days before the change takes place. The SEN must include all information that is reasonably necessary for a product holder to understand the nature and effect of the event.

If the change is not an increase in fees or charges, then the SEN should be given before the change or event occurs or as soon as practicable after, but not more than 3 months after the change or event occurs. However in some cases the SEN may be given more than 3 months after the change or event occurs if the issuer reasonably believes that the event is not adverse to the holder's interests and accordingly, the holder would not be expected to be concerned about the delay in receiving the information. In this case, the information must still be given within the period of 12 months after the change or event occurs. By relying on this provision, issuers can provide updates by other member communications such as annual reports, making it a more cost-effective option with less operational impact.

## **MISLEADING OR DECEPTIVE CONDUCT**

A PDS is defective if it includes a misleading or deceptive statement that is materially adverse. The term "misleading" is defined at sections 12BA and 12BB of the ASIC Act as where:

- a person has made a representation to a future matter (including the doing of an act); and
- the person does not have reasonable grounds for making the representation (but the 12BB definition expressly states (at section 12BB(4)) that it does not limit what is meant by the term misleading.

The term "deceptive" is not defined under the ASIC Act or the Corporations Act.

In its paper, 'The AFCA Approach to Misleading Conduct', the Australian Financial Complaints Authority outlines misleading conduct as conduct that:

- leads, or is likely to lead, someone into error or to believe something that is false;
- can happen when a financial firm says something that is wrong, acts in a way that misleads a complainant or does not say or do something when it should; and
- can occur even if the financial firm did not mean to mislead or the complainant could have found out the true position by looking into the matter further.

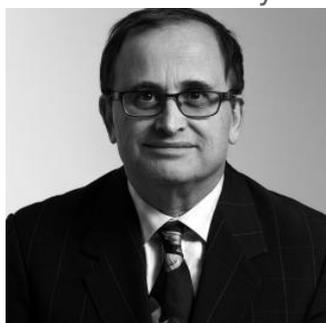
Therefore, it is important to ensure that despite the means by which the update is communicated to the product holders, any updates of the information contained in the PDS will not be rendered misleading as a result of the updated information.

This continues to be an area of regulatory focus by ASIC.

[Click here to read the second article in our series](#)

## KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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