9 December 2022

Australian Law Reform Commission
Review of the Legislative Framework for
Corporations and Financial Services Regulation
BRISBANE QLD 4000

By email: financial.services@alrc.gov.au

Dear Commission

Interim Report B – Financial Services Legislation

1. Thank you for the opportunity to respond to the issues raised in Report No 139 Interim Report B. The focus for Stage B of the Commission's reference is on the coherence of the regulatory design and hierarchy of laws, rather than the content of legislation. The terms of the reference require the Commission to consider whether, and if so what, changes to the *Corporations Act 2001* (Cth) and the *Corporations Regulations 2001* (Cth) could simplify and rationalise the law relating to corporations and financial services.

2. The Commission's rich analysis of the existing legislation indicates that there are problems with both the design and the hierarchy of Australia's financial services laws. While some of these can be addressed within the Commission's terms of reference for this Review, there are three obvious difficulties.

3. The ***first*** is that the financial services laws are spread across several statutes that cry out to be reorganised and rationalised, but the reference relates only to Corporations Act and Regulations (and legislative instruments made under them). The ***second*** is that the reference requires the Commission to work 'within the context of existing policy settings'. Interpreted too narrowly, this could make it difficult for the Commission to recommend anything more than the repeal of spent or redundant provisions and the relocation of existing provisions within and between each tier (primary law provisions, regulations, class orders, and standards) of legislation. Both are useful early steps, but they will not resolve the underlying problems with the financial services law that result from more fundamental design decisions made in CLERP 6 and since. The ***third*** is that the reference, expressed to cover both corporations law and financial services law, requires the Commission to address several disparate branches of the commercial law that are conceptually dissimilar and that, for that reason, require different regulatory design solutions. I return to these difficulties, and how they might be managed, below.

4. This letter makes the following key points:

    a. The structure proposed in B1 (an Act, a Scoping Order and rulebooks) would improve navigability, including by consolidating the law and keeping it updated in real time, creating a single source of truth as to whether regulatory requirement

applies to a particular entity or activity, and allowing users to ignore rulebooks that do not apply to them. But it does not address more fundamental design questions: whether the current coverage of the Corporations Act is appropriate (the coherence point); whether it is desirable to enact legislation that requires extensive scoping to make it workable (the scoping point); and whether the rules for 'giving effect to the Act in different regulatory contexts' belong in legislation as distinct from non-law codes or practice guides (the detail point). The latter involves careful consideration of what legislation (as distinct from non-legislative norms and strategies to influence commercial behaviour) is for; the answer determines who gets to make it and what consequences should flow from non-compliance.

b. If there are to be legislative rules, then who gets to make them (as between the Minister or the Australian Securities and Investments Commission (ASIC)) is almost a second-order issue. Assuming that proper Executive accountability exists and proper lawmaking processes are followed, then any legislative rule should be made by the entity that is closest to the problem.

c. For a durable solution to the problems identified by the Commission, we need to address the underlying failures of regulatory stewardship that caused or exacerbated them. There is an ongoing problem with the quality of business lawmaking – that is, with the laws as presented viewed separately from the policy decisions that the laws are intended to express. An obligation to explain how any rules reflect the legislative objects and the proposed Rules Advisory Committee may help but are not the whole solution. Reinstatement of an expert standing body like the former Corporations and Markets Advisory Committee (CAMAC) is needed, along with a genuine commitment by the Treasury Ministers, the Department, and its agencies to follow proper processes (including meaningful consultation and regulatory impact analysis) in lawmaking.

d. In my submission on Interim Report A, I suggested that, if breaking the Corporations Act into thematically separate parts is not possible, a 'chapeau and books' model might help address the coherence point. I still think this would be a useful exercise, provided it recognises that the current Ch 7 of the Corporations Act is not a single book. It is important to preserve the distinction between the regulation of financial markets (capital markets, derivatives markets, FICC markets) and the regulation of financial consumer transactions. There are problems with the existing division between Ch 6D and Pt 7.9 of the Corporations Act, but this should be fixed rather than further blurred.

e. The proposals in Interim Report B are directed at Ch 7 of the Corporations Act as a whole, but Ch 7 itself is not internally coherent. For Interim Report C, I suggest that the Commission focus specifically on those parts of Ch 7 that contain (some of) the financial consumer protection laws. This is where the need is the most pressing. Trying to solve the 'Ch 7 problem' without understanding that the problem might be that Ch 7 is fundamentally incoherent might make things worse. I suggest starting by properly framing of the financial consumer law, before deciding whether other parts

of the Corporations Law might either follow that model or be better left undisturbed. By narrowing its focus, the Commission could provide a legislative design model that allows for the future integration of all the financial consumer law (including consumer credit). It might also provide a model for modernisation of other parts of the law (such as corporate law, capital markets law, or insolvency law) but does not depend on it.

5. I attach a copy of my 2008 essay from *Economic Papers* entitled 'Improving the Process of Change in Australian Financial Sector Regulation'.[1] This essay introduces some of the themes and concepts used below.

The proposed legislative model

6. The proposed structure (an Act, a Scoping Order and thematic rulebooks) would improve navigability, including by consolidating the law and keeping it updated in real time, creating a single source of truth as to whether a regulatory requirement applies to a particular entity or activity, and allowing users to ignore rulebooks that do not apply to them. But it does not fully address the more fundamental design questions of coherence, scoping, and detail.

7. The current Corporations Act is not internally **coherent**. The punchline of the well-known joke about directions to Dublin is, 'I wouldn't start from here if I were you'. Modernising the Corporations Act has that precise problem. For historic and constitutional reasons, it includes a hotchpotch of unrelated laws and, in some areas including financial consumer protection, not the whole of the relevant law.[2] The result is not just that the statute is unwieldy and hard to navigate. It also obscures the fact that legislation that is designed to achieve different objectives and addressing different parts of the economy has a different design logic. (For example, as a matter of design logic, why do we have an Australian Consumer Law and a National Credit Code, but not an Australian Financial Consumer Law?) I have previously proposed reorganising the current Corporations Act into its component parts (corporations law, collective investments law, financial reporting and disclosure, insolvency, financial markets operators and traders, financial service providers, and a financial consumer law) to begin to tackle this problem. Note that, on this model, the licensing regime for financial intermediaries is separate from the financial consumer law.

8. Where regulation is concept-related or domain-related but spread across different statutes,[3] this undermines the Commission's aim for a single source of truth, creates opportunities for regulatory arbitrage, and leads to different (and sometimes inconsistent) regulatory responses

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[1] Pamela Hanrahan (2008) 'Improving the process of change in Australian financial sector regulation', *Economic Papers: a journal of applied economics and policy*, vol. 27, 6 - 23, http://dx.doi.org/10.1111/j.1759-3441.2008.tb00438.x.

[2] This also has flow-on implications for the role and structure of ASIC and the logic of the 'twin peaks' model, which I note are out of scope for the Review. See Pamela Hanrahan (2019) 'Twin peaks after Hayne: tensions and trade-offs in regulatory architecture', *Law and Financial Markets Review*, vol 13:2-3, 124-130, http://dx.doi.org/10.1080/17521440.2019.1622849.

[3] For example, for financial consumer law – the Corporations Act Pts 7.7 – 7.9A and 7.10A, the *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act) Pt 2 Div 2, the *National Consumer Credit Protection Act 2009* (Cth) (NCCP Act), the *Insurance Contracts Act 1984* (Cth), and relevant non-prudential parts of the banking, life insurance, health insurance and superannuation legislation.

to the same underlying policy problem. Where these different statutes covering the same field can be integrated, this makes sense. If the terms of reference confine the Commission to dealing just with the Corporations Act in this Review, then the design decisions it makes now should clear the way for integration of the law that is current spread across other statutes as a subsequent project.

9. Chapter 7 also has a **scoping** problem, discussed in my submission on Interim Report A. The CLERP 6 decision to adopt an overarching legislative framework for Ch 7 that is then turned off and on for classes of entities or activities has the consequence of *baking in* complexity. Given this broader context, the idea of having a Scoping Order makes sense for navigability and may also flush out inconsistencies in the current regime which are less obvious when they are not proximate. Conceptually, it probably includes the perimeter definitions (such as whether something is a financial product or a financial service), the purpose of which I discussed in my submission on Interim Report A. Practically, this model reduces the chances that regulators, regulated entities, and advisers will miss things.[4] But, as Giles JA observed in *International Litigation Partners Pty Ltd v Chameleon Mining NL*, wide statutory language narrowed by specific exemptions 'may not be a desirable way to legislate, quite apart from the difficulty of tracking through the provisions and seeking to apply sometimes imprecise and convoluted language'.[5]

10. I note that, in the final report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Commissioner Hayne said that 'eliminating exceptions and qualifications is the first step towards a simpler and more readily understood body of law'.[6] Consolidating the exceptions and qualifications in a Scoping Order does not go this far, presumably because the Commission considers that eliminating exceptions and qualifications involves questions of policy. Even if they are not policy questions, any substantive changes must be carefully exposed and tested before they are enacted (maybe by creating a 'digital twin' of the restructured law that runs parallel to the old law for a test period).

11. On scoping, it is important that ASIC retains the capacity to grant individual relief, which should be made available on a searchable public register maintained by ASIC. This is reflected in Proposal B3, with which I agree.

12. The **detail** point is also fundamental. It is not about whether legislative detail is needed or not – this is a question of 'optimum precision' and the appropriate level of detail in any law entirely depends on the context.[7] It is about where detail belongs, who decides it, and what the consequences of a regulated entity's failure to implement the detail should be.

13. My big-picture comment (but deeply grounded in regulatory theory) is that much of the 'detail' currently in the Act, the regulations, and ASIC instruments would be better dealt with in non-law

[4] For example, in *ASIC v Citigroup Global Markets Australia Pty Ltd* [2007] FCA 963, ASIC seemingly missed that investment banking was expressly excluded from being treated as the provision of a financial service for the purposes of the Corporations Act, by reg 7.1.29(3)(c) of the Corporations Regulations.
[5] (2011) 82 ACSR 517; [2011] NSWCA 50 at [74]. See A Black and P Hanrahan (2021) *Securities and Financial Services Law*, LexisNexis Butterworths, 10th ed, [3.1] – [3.4].
[6] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (2019) *Final Report*, 494.
[7] See Hanrahan (n 1).

documents like codes of practice and guides that are co-designed by those directly impacted by them (that is – regulators, regulated entities, and their customers and counterparties). There is a general tendency in Australia to overuse 'law-law' to direct and control commercial behaviour. Law is coercive, reactive, and distorts the compliance culture of regulated entities by privileging technical over substantive compliance. The law is one vital leg of the tripod that supports responsible business conduct, but it is only one. The other two legs – ethical responsibility and commercial (or professional, where relevant) accountability – must also be fostered and developed, not crowded out by a rule-design framework that misunderstands what the law-law leg of the tripod is for and how it is best deployed.

14. So, rather than ossifying the problem, why continue to default to law as the only or best solution to getting regulated entities to the outcome that we want to achieve? Why have thousands of trivial and sometimes inconsistent legal obligations that are never enforced by the regulator and breach of which can never support a private law remedy? Why undermine the unique expressive power of law in this way? Why not share responsibility for devising good rules with those affected by them? Why not properly fund civil society organisations (for example, consumer bodies) to participate on an equal footing with powerful financial sector entities in the rule-design process? In this regard, the Commission may wish to revisit the work on codes of conduct in the financial sector done by the ASIC Enforcement Review Taskforce in 2017.[8]

15. Moving as much of the detail as possible to non-law instruments fixes other concerns with the structure in Proposal B1, including who is the appropriate rule-maker (answer: the co-designers through a properly resourced secretariat within the policy boundaries drawn by the Act), what the consequences of a breach should be (answer: none, we only care about breaches of the Act), and what the status of the detailed non-law rules should be (answer: they firmly indicate to regulated entities, regulators, courts, tribunals, and internal and external dispute resolution bodies what good practice looks like where that is relevant to their decision-making, but non-adherence does not raise an evidentiary presumption of a breach of the Act).

16. At a practical level, there is a risk that the structure proposed in B1 might lead to a proliferation of scoping and detail, exacerbating rather than reducing complexity. This is because, arguable, the more law-law that can be made without the sea-anchor of parliamentary process the more of it there is likely to be. The law should be nimble when needed but settled where possible. It might help to have a standing commitment from Treasury for two 'modernisation' bills a year through which necessary amendments to the Act can be made on a measured basis (see my comments below about regulatory stewardship).

17. It may be that using co-designed non-legislative rules is considered a 'step too far' for the Commission's current reference. But I hope the final report can raise the question – well explored in the regulatory theory field – of whether we could achieve better legislation by having less of it.

Who holds the pen

18. It follows from my comments in paragraphs 11-17 that rules that are not 'core' enough to belong in the Act should be formally co-designed by those on whom they impact. Whether ASIC or

[8] Commonwealth of Australia, The Treasury (2017) *ASIC Enforcement Review Taskforce Report*, Ch 4.

Treasury should hold the pen is a second-order issue. (The Commission will doubtless hear examples of bad lawmaking by both.) If the scrutiny (including disallowance) and the proper processes (including consultation and impact analysis) to which they are subject as lawmakers is the same, the task should fall to the branch that is best resourced to do the work and closest to the people affected by it. In many situations this is likely to be ASIC, which is subject to various oversight mechanisms but which would also benefit, in my opinion, from having independent non-executive Commission members and dividing into specialist Divisions, both of which are permitted under its current Act.

Regulatory stewardship

19. The Commission has identified why financial services law can never be 'set and forget'. This makes proper regulatory stewardship[9] in this area even more important than elsewhere. Regrettably, formal best-practice controls on lawmaking by Parliament and the Executive (such as meaningful – not performative – consultation, regulatory impact assessment, financial impact assessment, and human rights impact assessment) that are intended to encourage good regulatory stewardship are routinely ignored or downplayed by those bodies.[10]

20. If skills and experience (and institutional memory) among policymakers and parliamentary drafters are lost, they are hard to replace. This is likely a factor also.

21. The Commission has included proposals to address the regulatory stewardship problem, including requirements to explain how new rules reflect legislative objects. However, this will only help if it is accompanied by a change in culture within the rulemaking bodies. (For example, a statement that a rule reflects the legislative object of protecting financial consumers will not take us very far.) It requires a genuine commitment by the Treasury Ministers, the Department, and its agencies to follow proper processes (including meaningful consultation and regulatory impact analysis) in lawmaking, including by dedicating adequate resources to the task. This includes understanding that business regulation is a vital form of economic infrastructure that, like roads and tunnels, needs to be maintained and improved over long timeframes.

22. The Commission's proposed Rules Advisory Committee runs a risk of being left to react to proposals (rather than to initiate them) and, by being representative, becoming partisan. If established, it should be clear that it is intended to function as a board with diverse members, rather than a stakeholder advocacy body or vehicle for hammering out compromises. In my view, reinstatement of an expert standing body like the former Corporations and Markets Advisory Committee (CAMAC) is a better solution. The body should be recognised in the ASIC Act and appropriately and independently resourced. A daughter-of-CAMAC body could have a standing brief to maintain the legislative infrastructure for corporations and financial services law operating on an independent, expert, and non-partisan footing.

[9] See, for example, this explanation of regulatory stewardship by the Aotearoa New Zealand Ministry of Justice.

[10] For example, the Explanatory Memorandum to the Financial Accountability Regime Bill 2022 says the financial impact of the legislation is 'nil'. This is clearly incorrect. It also says that no regulatory impact assessment was done because the Financial Services Royal Commission Final Report was an adequate substitute. This is despite the fact that the Royal Commission recommended that the BEAR be applied to superannuation and insurance, not that the BEAR be replaced by the (different) FAR.

Perimeter dilemmas in disclosure laws

23. As part of its work on design, the Commission looks at 'financial product disclosure' and the dividing line between the disclosure laws in Ch 6D (securities) and Pt 7.9 (other financial products). I will not comment on the substance of the recommendations, but I repeat these three observations.

24. First, the design difficulties in the existing disclosure laws are, fundamentally, definitional problems. Horses in some places are divided into greys and bays, and in others are lumped in with donkeys. The existence of mules is largely ignored. I know this will be a significant issue for Interim Report C.

25. Second, the purpose of the disclosure required by Ch 6D and that required by Pt 7.9 is different. Ch 6D reflects traditional securities law framing and is about supporting price formation by markets. In clear contrast, Pt 7.9 disclosure is intended to support individual decision-making by households and small businesses, by providing the information they need to choose products for their use (consumption) – like banking products, insurance products, and some collective investment products – that are suitable for them. Securities law framing should apply to financial instruments that are capable of being traded (whether they are or not) and consumer law framing should apply to consumer financial products. The fact that retail investors might want to acquire financial instruments in the first group does not make those financial instruments into consumer products.

26. Third, retail collective investments straddle the line between financial product and financial service, which is conceptually challenging. This includes public offer superannuation products and open-end managed funds. (There are registered managed investment schemes that are not managed funds – these should be regulated like securities and include listed property and infrastructure schemes.) It might help the Commission to think about disclosure for managed funds being more about the service provided by the operator (the RSE licensee, responsible entity, corporate director of CCIV or the board of LIC) than the underlying investments of the fund. The product being acquired by the household is actually the contract for funds management and administration provided by the operator.

A financial consumer law

27. Elephants are best eaten one bite at a time. Australia's corporate law, securities law, financial markets law, collective investments law, and insolvency law would all benefit from ongoing expert and specialist law reform projects (perhaps modelled on the Corporate Law Simplification Project of the 1990s or the American Law Institute restatement projects) conducted by a specialist drafting Commission under the leadership of the new daughter-of-CAMAC.

28. But the Australian financial consumer laws are a problem on an entirely different scale. They must be addressed urgently and, it seems to me, suggest a different design solution that better reflects and accommodates the unique features of consumer law. This includes appropriate re-scoping, by replacing the key concept of a retail client in this context (but not in the securities law context) with a definition of financial consumer that corresponds to the coverage of the AFCA regime.

29. I encourage the Commission, in Interim Report C, to design a legislative model that is fit for purpose for legislating for the protection of financial consumers who use financial products and services sold to them by authorised or licensed financial firms.[11] This is not necessarily the same design as is needed for other parts of the (existing) Corporations Act.

30. In arriving at new design principles following feedback on Interim Report B, the Commission should aim for a model that can be used across all the financial consumer laws, including those parts that currently appear in other statutes, with a view to their eventual consolidation and rationalisation.

31. I wish the Commission well with the next stages of the reference.

Yours sincerely

[redacted]

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[11] This includes firms authorised or licensed by APRA (including ADIs, insurers and superannuation trustees) or ASIC (including AFS licensees and credit licensees).