MinterEllison.

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Australian Law Reform Commission
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Dear Commissioners

Submission on ALRC Financial Services Legislation: Interim Report B (ALRC Report 139)

We appreciate the opportunity to make a submission in relation to the Australian Law Reform Commission (**ALRC**) *Financial Services Legislation: Interim Report B* released on 30 September 2022 (**Interim Report B**).

MinterEllison is a leading Australian law firm. We advise major financial institutions, including banks, insurance companies and superannuation funds, as well as specialist fund managers, platform operators, financial advice firms, stockbrokers, and other financial intermediaries in Australia and overseas.

The views expressed in our submission are ours alone and do not necessarily reflect the views of our clients.

We support all of Recommendations 14 to 19 in Interim Report B. Subject to our comments in this submission, we also generally support the proposals made in the Report.

In particular:

(a) We strongly support the proposal to upgrade the legislative hierarchy for the financial services regime, with an Act which provides the framework for the regime and sets the standards of conduct expected of financial service providers but delegates the role of setting the boundaries of the regime and detailed rules where required after appropriate consultation to an independent regulator as broadly proposed in Proposals B1 to B6.

(b) We agree that it is critical that any rule-making power should be subject to appropriate oversight and also suggested expanding the mandate of the Financial Regulator Assessment Authority (**FRAA**) for that purpose in our response to Proposal B9.

(c) We also strongly support the proposal to require consultation before making or amending the Scoping Order or rules. As noted in our responses to Proposals B9 and B13, we believe such consultation should be mandatory unless there is an urgent requirement to make the change (which should be subject to appropriate oversight).

(d) We have suggested a different approach to penalties in our response to Proposals B7 and B15.

(e) We strongly disagree with the proposal to give the Minster and ASIC concurrent powers to make the Scoping Order and rules for the reasons set out in in our response to Proposal B8.

Insurance Australia Group (**IAG**) commissioned us to prepare a report on general insurance regulation (**MinterEllison Report**) which we understand will accompany IAG's submission to the ALRC in relation to Interim Report B. The MinterEllison Report recommends implementation of a set of design principles which are similar in many respects to many of the ALRC's proposals in Interim Report B. While we have drawn on those design principles in this submission, we have not repeated them here. Nevertheless, we stand by the design principles in the MinterEllison Report and commend them to the ALRC for consideration in its further work on the Review of the Legislative Framework for Corporations and Financial Services Regulation.

Our detailed submissions in response to the proposals and questions raised in the Report are set out below

1. A legislative model for financial services

Proposal B1: The legislative hierarchy of Chapter 7 of the Corporations Act 2001 (Cth) should be amended, in a staged process, to implement a legislative model that incorporates Proposals B2–B9. The legislative hierarchy should comprise:

a. *an Act legislating fundamental norms and obligations, and other provisions appropriately enacted only by Parliament;*
b. *a Scoping Order (a single consolidated legislative instrument) containing exclusions, class exemptions, and other detail necessary for adjusting the scope of the Act; and*
c. *thematic 'rulebooks' (consolidated legislative instruments) containing rules giving effect to the Act in different regulatory contexts as appropriate.*

We broadly agree with the legislative hierarchy proposed by the ALRC in Proposal B1. We consider that such a hierarchy may assist to reduce some of the complexity in the financial services regulatory regime.

However, we believe that it would be better to move the financial services legislative regime from the *Corporations Act 2001* (Cth) (**Corporations Act**) into separate legislation. This 'Financial Services Act' could incorporate other legislation currently applying to financial services as separate chapters. This would have the benefit of having all financial services legislative located in one place and would facilitate the use of common terminology and definitions across the financial sector.

Although the proposed legislative hierarchy may assist with reducing complexity by enhancing the navigability of the legislation within the existing policy framework (to the extent that the Primary Act, Scoping Order and Rules within the hierarchy are organised in a clear and consistent manner), we believe that it is important to also consider the whether specific elements of the legislation are required or whether they could be simplified or removed to reduce complexity of regulation and the regulatory structure.

If the proposed model is to be effective, it is essential that the Act does only contain key obligations and prohibitions, i.e. the 'fundamental norms and obligations', along with mechanical provisions such as the those relating to obtaining a licence and enforcement related provisions. It should not contain any prescriptive provisions. However, we are concerned that the prototype legislation proposed by the ALRC (**Prototype Legislation**) appears to include more prescriptive detail than we believe is necessary or appropriate for principles-based legislation.

The Prototype Legislation sets out a specific regime for disclosure documents, including when they are required to be given and the contents of the document. These are essentially mirror certain aspects of the existing PDS provisions in Part 7.9 of the Corporations Act. It is true that these provisions do not contain all of the detail currently found in the Corporations Act. However, it is we believe still too prescriptive. In our view, the financial services statute could simply contain a very general set of enforceable principles with all of the detail left to the rules made by the regulator to the extent required. For example, the principle for disclosure could be as simple as:

> *A financial services provider must ensure that consumers have the information they can reasonably be expected to need to make decisions relating to the services or products provided by the provider and must communicate information to them in a way which is clear, fair and not misleading.*

Proposal B2: Chapter 7 of the Act should be amended to include a power to:
a. exclude classes of products and services or exempt classes of persons from provisions of Chapter 7 of the Act; and
b. set out detail that adjusts the scope of any provisions in Chapter 7 of the Act;
in the Scoping Order.

We agree with the proposal that the boundaries of the financial services regime should be able to be set in delegated legislation. It is important that regulators should have the ability to adjust the boundaries of the regime quickly to be able to respond to the rapid pace of change in the financial sector. It is also important to ensure that the power to set boundaries is explicitly given to an independent statutory authority in a form that makes it clear that the authority is expected to and is responsible for ensuring that the reach of the financial services regime is at all times appropriate.

However, we note that the Prototype Legislation only includes the current general categories of financial product and only contains a power to exclude products from those definitions. While we acknowledge that this reflects the approach proposed by the ALRC in Interim Report A, our concerns about that approach remain. In particular, we do not believe there is any reason not to include the list of specific inclusions currently found in section 764A of the Corporations Act, whether that list is found in the Act or the proposed Scoping Order. The specific inclusions provide certainty that the general financial product definition in section 763A of the Corporations Act does not provide.

Proposal B3: Chapter 7 of the Act should be amended to include a power vested in the Australian Securities and Investments Commission to exempt a person from provisions of Chapter 7 of the Act by notifiable instrument (commonly known as 'individual relief').

We believe that ASIC's power to grant relief in relation to the requirements of the current Chapter 7 is essential to its operation. However, that reflects the prescriptive nature of the current regime.

As we have indicated, we believe that the Act establishing the financial services regime should be principles-based. In our view, the principles established by the Act should be standards that are self-evident and not controversial. They should be principles that the community, consumers and companies alike, can agree are the appropriate standard for providers of financial services and which ensure and promote consumer confidence in the sector. There should not be any need to provide 'exemptions' from such principles. The regulator should simply be able to make rules that prescribe how such principles are implemented in specific situations where required (i.e. where the statement of principle alone does not provide enough certainty to providers or where there is evidence that providers are not complying with the spirit of the principle). The regulator should also be able to specify safe harbours for complying with the principle and we support Proposal B16 for that reason.

Proposal B4: Chapter 7 of the Act should be amended to require that:
a. every legislative instrument made under the power set out in Proposal B2; and
b. every notifiable instrument made under the power set out in Proposal B3;
must be accompanied by a statement explaining how the instrument is consistent with relevant objects within Chapter 7.

We strongly support this proposal.

Proposal B5: Chapter 7 of the Act should be amended to include a power to make 'rules'.

We strongly support this proposal, provided there are sufficient controls on the process for making rules, including strong measures requiring consultation (and providing sufficient time for proper consultation) and ensuring there is effective oversight of the process for making rules, including the ability for stakeholders to challenge rules on the basis of adequacy of consultation, adequacy of transition periods and measures and whether the rule is needed to give effect to the objects of the regime and the legislated principles. There should also be a legislated standard against which the rules can be measured, e.g. they should be clear, concise and effective.

Proposal B6: Chapter 7 of the Act should be amended to require that the explanatory statement accompanying every legislative instrument made under the power in Proposal B5 must address explicitly how the instrument furthers relevant objects within Chapter 7

We strongly support this proposal.

Proposal B7: Rules made under Chapter 7 of the Corporations Act 2001 (Cth) should not contain matters more appropriately enacted in primary legislation, particularly:

a. serious criminal offences, including offences subject to imprisonment, and significant civil penalties;
b. administrative penalties; and
c. powers enabling regulators to take discretionary administrative action.

We take a somewhat different approach to the ALRC on this question. In our view, the Act should require financial service providers to comply with the rules. Failure to comply with the rules should give rise to criminal sanctions (where intentional or reckless) and civil penalties. We would expect the penalties for failure to comply with a rule to reflect the current penalties in the Act for serious contravention.

However, we recognise that the prescriptive nature of the rules may mean that some rules should not be subject to such a high maximum penalty. We therefore believe that it would be appropriate for the regulator to have the power to 'dial down' the penalty that would otherwise apply for breach of a rule. Given the regulator would be reducing the penalty, we do not believe it is necessary or appropriate to impose any limits on the ability of the regulator to do this in the rules.

Proposal B8: The powers set out in Proposal B2 and Proposal B5 should be vested in:

a. the Minister; and
b. the Australian Securities and Investments Commission.

A protocol between the Minister and the Australian Securities and Investments Commission should coordinate the exercise of the powers.

We are strongly opposed to the proposal to provide the Minister and ASIC with concurrent powers in relation to the same delegated legislation. Our primary concern is that having two authorities with equal power to adjust the boundaries to the regime and to make rules will diminish the authority of both. The proposal is likely to mean that neither the Minister nor the regulator takes responsibility for ensuring the regime is effective and has the appropriate reach. If implemented, we are concerned that the proposal could well lead to responsibility-shifting or 'passing the buck' between them. In relation to the regulator, i.e. ASIC, this proposal will significantly diminish its authority and independence and will place it firmly under the political control of the Minister as the Minister will be able to override any rule made by making their own rule. It is a recipe for complexity and potential chaos.

We do not believe that that this proposal is consistent with the principles proposed by the ALRC in the Draft Guidance for delegating legislative powers in Annexure E of Interim Report B, in particular the principle that the law should be clear and predictable in relation to the delegation of legislative power (p 251 of the Report). The ALRC states that:

> *Provisions that do not clearly allocate responsibility for making delegated legislation can undermine the law's clarity, both in terms of how the law is expressed and in terms of understanding what the law requires.*

We acknowledge that a protocol between the Minister and the regulator to coordinate the exercise of the relevant powers should diminish the risks we refer to above. It does not however eliminate them and may to some extent exacerbate our concerns about the potential to comprise the authority and independence of the regulator.

We are not convinced that the sources of knowledge of the regulator and the Minister are so different that it requires them both to be given concurrent powers to make Scoping Orders and rules. As the ALRC has proposed in Proposal B9(b), the delegated legislation made by the regulator should be subject to mandatory and effective consultation. The Government or Treasury will therefore have the opportunity to share its knowledge with the regulator when it is making rules. If there is any concern that the regulator may not know of circumstances that mean that a rule should be made or changed, there should be

protocols in place for the Government to share its knowledge with the regulator which can then make an independent decision whether to make or change the rules accordingly.

We also expect that any rule made by the regulator will be subject to Parliamentary oversight and may be disallowed by either House of Parliament. As the Government controls at least the House of Representatives, it is in a position to disallow a rule made by the regulator if it believes it is not appropriate or exceeds its mandate.

We are strongly of the view that the Act should give the power to make rules to one authority only and in our view that should be an independent regulator, such as ASIC.

In relation to the Scoping Order, we believe that it would be appropriate for the Government to have the authority to set the boundaries for the regime, which can be set in the first instance through the Act, and amended through the Scoping Order. As such, we suggest that the ultimate power to make and amend the Scoping Order, should be vested in the Minister.

However, we acknowledge that the Government is often time and resource constrained in its ability to make delegated legislation and may also be subject to political constraints. There may therefore be merit in giving the regulator a back-up authority to make changes to the Scoping Order. However, we would suggest that primacy be given to the Minister in this area and therefore that the regulator's authority be initially confined to proposing changes to the Scoping Order which would only take effect if not rejected by the appropriate authority which could be either the Minister or Parliament within a prescribed period, e.g. six months (unless the regulator determines that the change is urgent based on prescribed criteria).

Proposal B9: Chapter 7 of the Act should be amended to:

a. *establish an independent 'Rules Advisory Committee'; and*
b. *require the Minister and ASIC to consult the Rules Advisory Committee and the public before making or amending any provisions of the Scoping Order or rules.*

We can see merit in the establishment of an independent Rules Advisory Committee to be consulted by the Minister and/or ASIC prior to making and/or amending both the Rules and the Scoping Order. If implemented, the timing for consultation should be specified, i.e. whether before or after public consultation takes place, although we would expect it to be before the commencement of the public consultation process.

We strongly agree with the proposal to require a public consultation process prior to making and/or amending the Scoping Order and/or rules. It is important that the requirement for consultation set out clearly the requirement to consult with all affected stakeholders and to give them adequate time to respond. A minimum consultation period should be specified. We believe that a 90 day minimum would be appropriate unless the regulator has determined that the rule change is urgent – where that occurs, the regulator should be required to state the reasons for urgency and it should be subject to appropriate oversight. Consultation periods should also be coordinated across the sector in recognition of the fact that consultation will not be effective when there are multiple significant proposals being consulted on at the same time.

We note however that it is proposed that failure to consult would not affect the validity of the delegated legislation. We do not believe that this is appropriate. The regulator should be held to the same high standards that applies to financial sector participants. Unless the regulator has made a formal determination of urgency, there is no excuse for not undertaking consultation. We acknowledge that it is difficult to assess the adequacy of consultation beyond certain key process obligations (e.g. the minimum period for consultation). However, there should be a mechanism to have the rule-making process review including whether there is adequate consultation. The mandate of the FRAA should be expressly extended to reviewing the delegated legislation made by the regulator, including whether there was appropriate consultation and the FRAA should have the power to at least send delegated legislation back to the regulator for reconsideration where the FRAA determines proper consultation did not occur.

Proposal B10: As part of the staged implementation of the proposed legislative model, existing powers to omit, modify, or vary relevant provisions of Chapter 7 of the Act by regulation or other instrument should be repealed.

We support this proposal. However, it should only take effect in a particular area once the regulator has full rule-making authority in that area.

Proposal B11: As part of the staged implementation of the proposed legislative model, relevant existing powers to:
a. exclude products or services; and
b. exempt a person or class of persons;
from the operation of all or specified provisions of Chapter 7 of the Act by regulation or other instrument should be repealed.

We agree that this proposal is the logical outcome once the relevant authority has the power to make the Scoping Order and rules. There will of course need to be appropriate transitional and savings provisions to ensure an effective transition to the new legislative hierarchy.

What goes where

Proposal B12: The Attorney-General's Department (Cth), in consultation with the Office of Parliamentary Counsel (Cth) and the Department of the Prime Minister and Cabinet, should publish and maintain consolidated guidance on the delegation of legislative power.

We agree with Proposal B12.

Question B13: Does the Draft Guidance included in this Interim Report:
a. adequately capture the principles that should guide the design of provisions that delegate legislative power;

We broadly support the Draft Guidance. In particular, we support the additional safeguard included in the Draft Guidance in relation to establishing or allocating responsibility to a review panel to report to Parliament on the exercise of the power. In addition, we suggest that such panel should also have the authority to refer legislative instruments back to the maker where the maker failed to undertake a public consultation process.

We do have some concerns that aspects of the Draft Guidance may not reflect the reality of regulating a complex industry such as the financial sector. For example, the Draft Guidance states the following matters (among others) should be included in the primary legislation:

- *provisions imposing burdensome obligations on individuals or organisations to undertake certain activities or prohibiting certain activities;*
- *variations to the common law, particularly if a common law right is to be taken away, or replaced, by legislation;* (para E.19)

While there is no doubt that it is preferable for such matters to be dealt with by the primary legislation, we believe that an effective rule making power is likely to require the regulator to be able to impose obligations on financial services providers or to prohibit certain activities. It may also be necessary to codify common law to provide certainty to providers and consumers.

We very much acknowledge that where a regulator is given such broad powers then it is essential to *'ensure appropriate safeguards apply to retain oversight and accountability.'* (para E.13) In our view, the Draft Guidance could go further to give explicit recognition to the circumstances in which the ideals it expresses mean that a different approach should be taken and then to provide guidance on the nature of approaches that should be taken to ensure that oversight and accountability is present. For example, as indicated above, we believe that the FRAA should be given explicit authority to review the rule-making activities engaged in by ASIC if the ALRC's proposals are implemented and this should be both at its own initiative as part of its regular review of the activities of financial services regulators and at the request of affected stakeholders.

We note that the Draft Guidance proposes that delegated legislation should only be permitted to override or modify the operation of an Act (including by way of notional amendments) in limited circumstances which we support. There is no doubt that much of the difficulty of the financial services regime under Chapter 7 of the Corporations Act stems from the use of notional amendments. In our view, if Parliament takes a principles-based approach to the legislation, then the need for notional amendments should be significantly reduced even if a broad rule-making power is appropriate for the activities or sector regulated. This should be incorporated into the Draft Guidance.

Furthermore, if notional amendments are to be permitted, then we strongly support ensuring there is a means for the principal legislation to show the existence of the notional amendments in the official text of the legislation as proposed by the ALRC. In our view, the commentary on this point in the Draft Guidance could be strengthened.

We also suggest that an additional safeguard to the alternatives proposed in para E.32 and discussed later in the Draft Guidance should be oversight by an independent statutory authority in relation to the use of the rule-making power, such as the FRAA in the case of financial regulators.

Where there is effective and independent oversight of a regulator with rule-making power, we are less convinced of the need for sunsetting provided that oversight authority has as part of its mandate the role of reviewing the body of rules made by a regulator and periodically requiring the regulator to justify the continued existence of the body of rules. While we acknowledge the value of sunsetting in forcing a regulator to review the operation of rules, we are concerned that could take valuable resources away from more important regulatory tasks if applied as a matter of course.

We also believe that consultation is a critically important element to effective law-making and this is, if anything, even more true for rule-making by an unelected body. We believe that consultation should be judicially enforceable do not understand the reluctance to make it so. Regulators should be subject to enforceable standards just as regulated entities are.

b. adequately capture the extent to which it is appropriate for delegated legislation to specify the content of offences or civil penalty provisions otherwise created by an Act; and

We refer to our comments in response to Proposal B7 above in relation to the creation of offences, civil penalties and the setting of penalties.

c. express the applicable principles with sufficient clarity?

We agree that the Draft Guidance expresses the principles with sufficient clarity.

Proposal B14: In order to support best practice legislative design, the Office of Parliamentary Counsel (Cth) should establish and support a Community of Practice for those involved in preparing legislative drafting instructions, drafting legislative and notifiable instruments, and associated roles.

We agree with this Proposal B14.

Offences and penalties

Proposal B15: In order to implement Proposal B1, offence and penalty provisions in corporations and financial services legislation should be consolidated into a smaller number of provisions covering the same conduct.

We agree that the range and number of offences and penalties provisions in Chapter 7 of the Corporations Act is unnecessarily large and complex. This is particularly true when the overlap with other provisions are considered, such as the consumer protection measures in the ASIC Act and specific measures for regulated entities under their specific legislation.

As discussed in our response to Proposal B7, we believe a simpler approach could be adopted. In our view the principles or standards of conduct expected of financial services providers should be articulated by Parliament. We would expect some standards of conduct to relate only to dealings with consumers and small businesses, while others may have more general application (such as some of those currently

contained in section 912A of the Corporations Act). These standards of conduct should be enforceable as should any rules prescribing conduct required of financial services providers to meet these standards, where the regulator determinations that such rules are required after appropriate consultation. This can give rise to a simple set of offences and civil penalties. Breach of the standards of conduct or rules should be an offences where done intentionally or recklessly and an appropriate penalty should be set in the legislation for intentional breaches and a lower penalty for reckless breaches. The maximum civil penalty for breach of a standard of conduct or rule should also be set in the primary legislation, with the regulator having the power to reduce the penalty for breach of a rule if it determines that is appropriate after consultation.

Question B16: Should rulebooks contain 'evidential provisions' that are not directly enforceable but, if breached or satisfied, may evidence contravention of, or compliance with, specified rules or provisions of primary legislation?

We strongly support the ability of the regulator to make 'evidential provisions' or safe harbours which enable financial service providers to have certainty that by following the rule they will have met the relevant standard of conduct. We believe that this is an essential element of a principles-based regime where enforceable standards of conduct are legislated by Parliament. While such standards of conduct should be self-evidently appropriate, they will by their very nature be hard to apply in particular circumstances. Where industry can demonstrate that it is appropriate to have a safe harbour in particular circumstances, the regulator should have the ability to provide that certainty which will enhance the efficiency and effectiveness of the sector (and the regulator should be satisfied that it will) and thereby reduce costs for the ultimate benefit of consumers.

Simpler law design

Proposal B17: The Corporations Act 2001 (Cth) should be amended so that each offence and civil penalty provision, and the consequences of any breach, are identifiable from the text of the provision itself.

We agree with Proposal B17.

Proposal B18: Offence provisions in corporations and financial services legislation should be amended to specify any applicable fault element.

We agree with Proposal B17.

We look forward to continuing to engage with the ALRC as it develops the financial services legislative framework. Please contact us if you have any questions about any aspect of our submission. We would be very happy to participate on any discussions on proposals or recommendations for changing the framework.

Yours faithfully
MinterEllison

Richard Batten
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