Submission to Australian Law Reform Commission

Interim Report A: Financial Services Legislation

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Introduction

This submission addresses the questions and recommendations put forward by the Australian Law Reform Commission regarding possible reforms to Australia's financial services regulation. The Interim report details a range of very important considerations. The data collected highlights the complexity of the financial services laws. Consequently, there is a need to change the legislative settings to maintain the sustainable of the regime.

If any of the responses require further explanations, please contact Associate Professor Marina Nehme at the University of New South Wales, Sydney, Faculty of Law and Justice at [redacted]

General Observation

The observations made in this submission can be summarised in the following manner:

- There is a need to conduct broader empirical research involving consumers and financial services providers to ensure that the matters targeted in the report and proposal being put forward would lead to the simplification of the legislation;
- This submission supports the approach taken regarding 'definitions.' However, the proposal that 'each word and phrase should be used with the same meaning throughout the Act' can be a challenge to achieve as certain words may have different meaning and interpretation depending on the context they operate under.
- The uniform definition of each of the terms 'financial product' and 'financial service' should be identical in all financial services legislations.
- This submission supports the repeal of the inclusion list regarding financial product definition under s 674A of the *Corporations Act 2001* (Cth) and s 12BAA(7) of the *Australian Securities and Investments Act 2001* (Cth).
- There should be limited use of regulation dealing substantial matters.
- This submission supports the move to consolidate, in delegated legislation, all exclusions and exemption from the definitions of 'financial product' and 'financial service.'
- This submission supports the amendments to financial product definition.

- Reframing the provisions regarding financial product disclosure to an outcomes-based standard of disclosure should consider the financial impact this may have on businesses. There is also a need to assess whether the regulator has the necessary resources to implement such an approach.
- Personal advice is a form of financial services and any separation would be artificial and unnecessary.
- A better education campaign is needed to enhance the public's understanding of general and personal advice.
- A shift in the definition and the terminology of 'retail client' is encouraged.
- The submission supports the removal of the wealthy investor test from the legislation.
- A objects clause is not needed within Chapter 7.
- A review of s 912A is desired however the submission questions the approach taken to it.

3. Empirical Data - Empirical Data Question A1: What additional data should the Australian Law Reform Commission generate, obtain, and analyse to understand:

a. legislative complexity and potential legislative simplification;

b. the regulation of corporations and financial services in Australia; and c. the structure and operation of financial markets and services in Australia?

The Interim Report has generated an impressive range of data for the project. However, what is lacking is empirical data regarding the public's perception of the provisions in the legislation and their understanding of it. This is important especially when discussing ways to simplify the legislation as this implies that the financial services law should be accessible to all. Accordingly, I recommend that the Australian Law Reform Commission collects empirical research (either quantitative or qualitative) of the perception of consumers (this can be done through discussion with consumer groups for example) to highlight the challenges the legislation poses to consumers to ensure all grounds are covered.

Additionally, empirical research should also be conducted with financial services providers to see the challenges they face when implementing and interpreting the legislation.

Collecting data from these two sources may provide validations to some of the findings that the report has put forward.

4. When to Define - Question A2: Would application of the following definitional principles reduce complexity in corporations and financial services legislation?

When to define (Chapter 4):

a. In determining whether and how to define words or phrases, the overarching consideration should be whether the definition would enhance readability and facilitate comprehension of the legislation.

I Agree. This is a very important consideration. Following from this, a definition should be easily understood by the average person. Currently, there are a number of definitions that are challenging to understand by the experts let alone the average person.

b. To the extent practicable, words and phrases with an ordinary meaning should not be defined.

c. Words and phrases should be defined if the definition significantly reduces the need to repeat text.

d. Definitions should be used primarily to specify the meaning of words or phrases, and should not be used to impose obligations, tailor the application of particular provisions, or for other substantive purposes.

I agree with the above principles.

Consistency of definitions (Chapter 5):

e. Each word and phrase should be used with the same meaning throughout an Act, and throughout all delegated legislation made under that Act.

This would be ideal of course. However, certain words may have different meaning and interpretation. A simple example can be found with the word 'may'. The word 'may' can be viewed as giving a person the option to do something or it may mean that a person is obliged to do something.[1] For example, in *Leach v R* (2007) 230 CLR 1, the High Court considered the meaning of the word 'may' in the context of s 19(5) of the *Sentencing (Crime of Murder) and Parole Reform Act 2003* (NT). This provision states that the Supreme Court 'may refuse to fix a non-parole period' if it is satisfied that the matters set out in the provision have taken place. The High Court determined that the word 'may' was not used to convey discretionary power on the Supreme Court. Instead, it gave a power that the court had to exercise if it was satisfied that the requirements of s 19(5) were met.[2] Similarly, in *Finance Facilities Pty Ltd v FCT* (1971) 127 CLR 106, Windeyer J stated:

> This does not depend on the abstract meaning of the word 'may' but of whether the particular context of words and circumstance make it only an empowering word but indicate circumstances in which the power is to be exercised – so that in those events the 'may' becomes a 'must'.[3]

f. Relational definitions should be used sparingly.

g. To the extent practicable, key defined terms should have a consistent meaning across all Commonwealth corporations and financial services legislation.

I agree with both principles. Having key terms defined in the same way in all relevant legislations would make it easier for consumers and businesses to operate. It would remove one of the many levels of intricacies that currently apply in financial services.

Design of definitions (Chapter 6):

h. Interconnected definitions should be used sparingly.

It is best to avoid interconnected definitions.

i. Defined terms should correspond intuitively with the substance of the definition.

j. It should be clear whether a word or phrase is defined, and where the definition can be found.

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[1] As noted in the *Oxford English Dictionary* (online version).
[2] *Leach v R* (2007) 230 CLR 1, 17–18.
[3] *Finance Facilities Pty Ltd v FCT* (1971) 127 CLR 106, 134; also see *MacDougall v Paterson* (1851) 11 CB 755, 766.

I agree with the above principles. Having all the definition in one place would be ideal. It will also make those definition accessible to the public as they will have a one stop shop to access them.

Proposal A3: Each Commonwealth Act relevant to the regulation of corporations and financial services should be amended to enact a uniform definition of each of the terms 'financial product' and 'financial service'.

Having uniform definitions for key terms is essential to enhancing access and understanding of the law.

Proposal A4: In order to implement Proposal A3 and simplify the definitions of 'financial product' and 'financial service', the Corporations Act 2001 (Cth) and the Australian Securities and Investments Commission Act 2001 (Cth) should be amended to:

a. remove specific inclusions from the definition of 'financial product' by repealing s 764A of the Corporations Act 2001 (Cth) and omitting s 12BAA(7) of the Australian Securities and Investments Commission Act 2001 (Cth);

This change is welcomed. The inclusion list is redundant as the functional definition that the legislation has is already very broad and covers the inclusions in both provisions.

b. remove the ability for regulations to deem conduct to be a 'financial service' by omitting s 766A(1)(f) of the Corporations Act 2001 (Cth) and s 12BAB(1)(h) of the Australian Securities and Investments Commission Act 2001 (Cth);

c. remove the ability for regulations to deem conduct to be a 'financial service' by amending ss 766A(2) and 766C(7) of the Corporations Act 2001 (Cth), and ss 12BAB(2) and (10) of the Australian Securities and Investments Commission Act 2001 (Cth);

This change is also welcomed. Additionally, I recommend the removal of definitions from the regulation as this adds a layer of complexity to the law. As a rule, substantial matters of law should be in the legislation while procedural matters may be in the regulation. It is concerning that, currently, the regulation is regulating a range of substantial matters, and this is adding to the complexity of the financial services regime.

d. remove the incidental product exclusion by repealing s 763E of the Corporations Act 2001 (Cth);

The removal of the reference to incidental product exclusion will simplify the assessment of whether a product is a financial services or not.

e. insert application provisions to determine the scope of Chapter 7 of the Corporations Act 2001 (Cth) and its constituent provisions; and

No comment.

f. consolidate, in delegated legislation, all exclusions and exemptions from the definition of 'financial product' and from the definition of 'financial service'.

While I personally believe in the minimal use of delegated legislation, the broad definitions of financial product and services and the rise of innovative business practices means that a range of products and services might fall under the existing definitions even though they should be exempt. Accordingly, to

keep the legislation agile, exclusion provision may need to be introduced quickly through delegated legislation. I support the move to consolidate, in delegated legislation, all exclusions from the definitions of 'financial product' and 'financial service.'

Proposal A5: The Corporations Act 2001 (Cth) and the Australian Securities and Investments Commission Act 2001 (Cth) should be amended to remove the definitions of:

a. 'makes a financial investment' (s 763B Corporations Act 2001 (Cth) and s 12BAA(4) Australian Securities and Investments Commission Act 2001 (Cth));

b. 'manages financial risk' (s 763C Corporations Act 2001 (Cth) and s 12BAA(5) Australian Securities and Investments Commission Act 2001 (Cth)); and

c. 'makes non-cash payments' (s 763D Corporations Act 2001 (Cth) and s 12BAA(6) Australian Securities and Investments Commission Act 2001 (Cth)).

The definition of these terms may be removed. There is enough guidance in the case law to provide assistance regarding the interpretation of these terms.

Proposal A6: In order to implement Proposal A3:

a. reg 7.1.06 of the Corporations Regulations 2001 (Cth) and reg 2B of the Australian Securities and Investments Commission Regulations 2001 (Cth) should be repealed;

b. a new paragraph 'obtains credit' should be inserted in s 763A(1) of the Corporations Act 2001 (Cth) and in s 12BAA(1) of the Australian Securities and Investments Commission Act 2001 (Cth); and

c. a definition of 'credit' that is consistent with the definition contained in the National Consumer Credit Protection Act 2009 (Cth) should be inserted in the Corporations Act 2001 (Cth) and in the Australian Securities and Investments Commission Act 2001 (Cth).

I support the repeal of the reg 7.1.06 of the *Corporations Regulations 2001* (Cth) and reg 2B of the *Australian Securities and Investments Commission Regulations 2001* (Cth).

The addition of 'obtains credit' to the definition of financial product will ensure consistency between the legislations. Further, having consistent definition of this term between the different Federal statutes will remove some of the existing complexities within the financial services regime.

Proposal A7: Sections 1011B and 1013A(3) of the Corporations Act 2001 (Cth) should be amended to replace 'responsible person' with 'preparer'.

I agree with the premise that we need consistency in the way which certain people are referred to across legislations. Accordingly, I recommend that the review goes further than the suggested proposal and consider ways to harmonise the terms used in the *Corporations Act 2001* (Cth) and the other Federal legislations. Further, the practice of using 'tag' should be discontinued and a more consistent approach should be adopted to lessen the complexity of the law. Consequently, a review of all tag words in Chapter 7 should be conducted.

Further, the example provided of 'regulated person' in the Interim Report is perfect to represent the confusion within the statute. Each term should have the same meaning across the legislation if the aim is to remove complexities within the law.

Proposal A8: The obligation to provide financial product disclosure in Part 7.9 of the Corporations Act 2001 (Cth) should be reframed to incorporate an outcomes-based standard of disclosure.

This proposal has merit. However, for it to be implemented properly and to ensure consumers' protection, an immense number of resources is required. For instance, regulators need to provide sufficiently guidance to businesses and should have the resources needed to monitor the disclosure documents to ensure compliance with the standards. Similarly, this will raise a cost for businesses as they will need to adapt their current systems to the new regime. In view of this, I recommend that the Committee consult with the industry to assess the impact of this proposal on their businesses.

Proposal A9: The following existing powers in the *Corporations Act 2001* (Cth) should be removed:

a. powers to grant exemptions from obligations in Chapter 7 of the Act by regulation or other legislative instrument; and

b. powers to omit, modify, or vary ('notionally amend') provisions of Chapter 7 of the Act by regulation or other legislative instrument.

Proposal A10: The Corporations Act 2001 (Cth) should be amended to provide for a sole power to create exclusions and grant exemptions from Chapter 7 of the Act in a consolidated legislative instrument.

Question A11: In order to implement Proposals A9 and A10:

a. Should the Corporations Act 2001 (Cth) be amended to insert a power to make thematically consolidated legislative instruments in the form of 'rules'?

b. Should any such power be granted to the Australian Securities and Investments Commission?

I question the need for such a change. In regard to the power to grant exemptions, omit, modify or vary the rules, this power should be a reflection of the intention of the Parliament and as such should be linked to the necessary provisions in the Statute itself. It does not really add any complexity to the legislation. The complexity comes elsewhere when people have to go to another piece of rules to figure out the exemption regime for instance. There are more appropriate investments that can be made that would lead to simplification of our financial services laws. This is not one of them.

However, if such a proposal goes ahead, the same need to be done in the context of the *ASIC Act 2001 and other legislations* (Cth) for example to ensure consistency of approaches.

Proposal A12: As an interim measure, the Australian Securities and Investments Commission, the Department of the Treasury (Cth), and the Office of Parliamentary Counsel (Cth) should develop a mechanism to improve the visibility and accessibility of notional amendments to the Corporations Act 2001 (Cth) made by delegated legislation.

This should be the rule, not the exception. Visibility is key to ensure accountability in the system.

Proposal A13: The Corporations Act 2001 (Cth) should be amended to:

a. remove the definition of 'financial product advice' in s 766B;

b. substitute the current use of that term with the phrase 'general advice and personal advice' or 'general advice or personal advice' as applicable; and

c. incorporate relevant elements of the current definition of 'financial product advice' into the definitions of 'general advice' and 'personal advice'.

Proposal A13 may be helpful in making the meaning of advice accessible to the public.

Proposal A14: Section 766A(1) of the Corporations Act 2001 (Cth) should be amended by removing from the definition of 'financial service' the term 'financial product advice' and substituting 'general advice'.

I do not support the decoupling of personal advice from financial services. It is important that any person providing personal advice is a financial service provided and has a range of obligations applying to them including s 912A of the *Corporations Act 2001* (Cth). Having provisions named 'financial service or personal advice' to ensure licensing occurs just leads to greater confusion and complexity of the rules. Consequently, I question whether the decoupling may lead to a simplification of the regime. It is very artificial. It may, in fact, result in greater confusion.

A better system is to clarify what are the rules a financial service provider must comply with in instances where they are providing personal advice versus general advice. Having a table reflecting the different obligation within the stature will remedy the issue of complexity referred to in the Interim Report.

Proposal A15: Section 766B of the Corporations Act 2001 (Cth) should be amended to replace the term 'general advice' with a term that corresponds intuitively with the substance of the definition.

I believe the current issue is less with the need to understand what the term means and more with education of consumer regarding the meaning of the word. Investing in education is more worthwhile then rebranding an existing concept that consumers may understand. A review of the current education programs attached to this term should be considered to see if there are other ways to enhance the meaning of this term to consumers. The same may be said about replacing the term 'personal advice'.

Question A16: Should the definition of 'retail client' in s 761G of the Corporations Act 2001 (Cth) be amended:

a. to remove:

i. subsections (5), (6), and (6A), being provisions in relation to general insurance products, superannuation products, RSA products, and traditional trustee company services; and

ii. the product value exception in sub-s (7)(a) and the asset and income exceptions in sub-s (7)(c); or b. in some other manner?

Question A17: What conditions or criteria should be considered in respect of the sophisticated investor exception in s 761GA of the Corporations Act 2001 (Cth)?

A review of the definition of retail client is welcomed. To ensure simplicity of the laws, it would also be encouraged for one terminology to be used across Federal legislation to reflect retail client as currently some legislations refer to 'consumers' rather than retail clients. This causes unnecessary complexity within the regime. One terminology across financial services should be enough.

Additionally, the wealthy investor test does not necessarily reflect the knowledge of the person. It only focuses on wealth. Wealth does not mean that the person may have the necessary financial literacy to deal with complex financial products. For example, a number of retired people have net assets worth $2.5 million. However, the rate of financial literacy in elderly people is low.[4] But even though this is the case, they may be deemed as wholesale clients. Similarly, people who may not be characterised as wealthy investors may fall under the definition of retail client and yet they may have the necessary knowledge and skill to enable them to make informed financial decisions without any help. Accordingly, a review of the asset and income exception is welcomed. In fact such an exemption should be removed from the legislation.

Question A18: Should Chapter 7 of the Corporations Act 2001 (Cth) be amended to insert certain norms as an objects clause?

Question A19: What norms should be included in such an objects clause?

I question the need for the insertion of certain norms as an objects clause. The six norms identified by the Financial Services Royal Commission are essential elements that are implied in Chapter 7. I question the need to spell them out. It is expected that the person obeys the law. A financial services provider should not be involved in misleading and deceptive conduct and this is apparent through all the misleading and deceptive provisions already in Chapter 7. The same may be said for the rest of the norms. They are just a reflection of our existing law and do not necessarily clarify existing provisions or lessen their complexity.

Proposal A20: Section 912A(1)(a) of the Corporations Act 2001 (Cth) should be amended by:

a. separating the words 'efficiently', 'honestly', and 'fairly' into individual paragraphs;

b. replacing the word 'efficiently' with 'professionally'; and

c. inserting a note containing examples of conduct that would fail to satisfy the 'fairly' standard.

[4] Annamaria Lusardi and Olivia Mitchell, 'Baby Boomer Retirement Security: the Roles of Planning, Financial Literacy, and Housing Wealth' (2007) 54 *Journal of Monetary Economics* 205; Tullio Jappelli, 'Economic Literacy: An International Comparison' (2010) 120(584) *The Economic Journal* F 429; Annamaria Lusardi and Olivia Mitchell, 'Financial Literacy and Retirement Preparedness: Evidence and Implications for Financial Education' (2007) 42(1) *Business Economics* 35; Maarten Van Rooij, Annamaria Lusardi and Rob Alessie, 'Financial Literacy and Retirement Planning in the Netherlands' (2011) 32(4) *Journal of Economic Psychology* 593;J Conrad Glass Jr and Beverly B Kilpatrick, 'Gender Comparisons of Baby Boomers and Financial Preparation for Retirement' (1998) 24(8) *Educational Gerontology* 719.

I agree that the elements of s 912A(1)(a) should be revisited as they may be viewed as contradictory in certain instances. As highlighted by the Interim Report, there has been issues with the way this provision has been interpreted. I would recommend the removal of the term efficiently as it may be viewed as contradictory to matters of fairness and honesty. Further defining 'efficiently' may be a challenge as it may mean different things depending on the person's perspective and discipline.

I question the need to have the word 'professionally' introduced. The values of honesty and fairness are enough to represent the values a financial services licensee must uphold. Professionalism is manifest through the rest of the obligations that are present in s 912A. Accordingly, it does not need to be spelled out. The same may be said regarding the use the word 'competence' in this context. The obligations under s 912A cannot be achieved if the financial services provider is not acting in a competent manner.

Proposal A21: Section 912A(1) of the Corporations Act 2001 (Cth) should be amended by removing the following prescriptive requirements:

a. to have in place arrangements for the management of conflicts of interest (s 912A(1)(aa));

b. to maintain the competence to provide the financial services (s 912A(1)(e));

c. to ensure representatives are adequately trained (s 912A(1)(f)); and

d. to have adequate risk management systems (s 912A(1)(h)).

I would recommend keeping the above concrete rules in the provision as the meaning of fairness and even the proposed professionalism may vary from discipline to discipline. They are more representatives of values organisations must aspire to.

Further, the provisions referred to in proposal A21 do not add a complication to this system. They are in fact self-explanatory. They clarify their legal obligations.

Proposal A22: In accordance with the principle that terminology should be used consistently to reflect the same or similar concepts, s 991A of the Corporations Act 2001 (Cth) and s 12CA of the Australian Securities and Investments Commission Act 2001 (Cth) should be repealed.

I agree with this. It is important for the same terminology to be used consistency throughout the statutes.

Proposal A23: In accordance with the principle that terminology should be used consistently to reflect the same or similar concepts, proscriptions concerning false or misleading representations and misleading or deceptive conduct in the Corporations Act 2001 (Cth) and the Australian Securities and Investments Commission Act 2001 (Cth) should be consolidated into a single provision.

This will be a great step to remove complexity in the different legislative regime.

Question A24: Would the Corporations Act 2001 (Cth) be simplified by:

a. amending s 961B(2) to re-cast paragraphs (a)–(f) as indicative behaviours of compliance, to which a court must have regard when determining whether the primary obligation in sub-s (1) has been satisfied; and

b. repealing ss 961C and 961D?

No comment.

Conclusion

This review of the financial services regime is welcomed. The principles behind the proposals are sound. However more can be done to ensure consistency between all the different commonwealth regimes as this may remove existing complexities in the regime. This Interim Report is just a start.

Associate Professor Marina Nehme

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