KING IRVING

Interim Report A: Financial Services Legislation

Submission to the Australian Law Reform Commission

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King Irving delivers integrated legal and consulting solutions for financial services through the provision of exceptional advice to our clients. We are a dynamic and inclusive team of lawyers and financial professionals who are active partners in our clients' success. Our firm prides itself on our collaborative spirit both internally and as an extension of our clients' team.

At King Irving, we align our advice with a deep understanding of our clients' businesses, including their changing goals and legislative obligations. We invest in our long-term relationships and offer more than legal insights, accelerating growth for our clients.

King Irving is at the nexus of the financial services regulatory environment. We offer an entrepreneurial approach, underpinned by our deep understanding of financial regulatory regimes. This allows us to offer contextualised and customised advice.

We have long identified the complexity and intricacies of the legislative regime as a key concern for our clients from both an operational and a compliance perspective. The expansive legislative framework and its innumerable amendments make it near impossible for Australian Financial Service ('AFS') Licensees to fully understand the full content and scope of their rights and obligations without dedicated advice.

BACKGROUND

This submission has been prepared in response to the Australian Law Reform Commission's ("ARLC") Interim Report A: Financial Services Legislation ("the Report").

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EXCLUSIONS, EXEMPTIONS AND NOTIONAL AMENDMENTS

1. THE PROPOSALS AND QUESTION

This submission has been prepared in response to Proposals A9 and A10 and Question A11.

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2. OVERVIEW AND PROCESS

We believe that Proposals A9 and A10 will greatly simplify and strengthen the legislative framework. The Proposals will reduce unnecessary complexity, enhance accessibility and cohesion of the law, and minimise costs for AFS Licensees.

Our submission analyses the perceived strengths and weaknesses of the Proposals following our consideration of the:

a. objectives of the proposed reforms
b. operational aspects of our clients' businesses
c. underlying legal issues, including the separation of powers and delegation of power
d. underlying policy and regulatory issues, including the complex balance between consumer protection and the needs for:
    i. improved consumer access to financial services
    ii. industry efficiency, innovation and growth.

3. PROPOSAL A9

The ALRC has proposed removing the following existing powers from the Corporations Act 2001:

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

3.1. Notional Amendments

It is our position that ASIC's powers to notionally amend Chapter 7 of the Corporations Act 2001 compounds existing complexities in financial services laws.

Whilst it has long been accepted that legislative power can be delegated to the executive, ASIC's powers are uniquely broad and unqualified in their scope. Their powers extend beyond supplemental amendments to address the practical, operational and circumstantial aspects of existing provisions. They also allow ASIC to modify the text of the Act as written. These amendments vary in scope, ranging from minor technical amendments to fundamental changes to the obligations of AFS Licensees.

With over 100 amending instruments in circulation, this concentration of power is problematic. Notional amendments have inadvertently created a 'shadow' legislative system. Licensees must be aware of the obligations under the Corporations Act 2001. They must locate, analyse and reconcile these obligations with ASIC instruments which potentially, notionally amend their rights and obligations under the Corporations Act 2001. The frequency with which the notional amendment powers have been exercised amplifies this issue.

This frequency potentially undermines the text of Chapter 7 as written. Whilst a notional amendment may be desirable in a single instance, numerous amendments to a provision, if compounded, risk unduly expanding, narrowing or otherwise eroding its policy and intent.

While we believe some of these concerns could be addressed by reducing the scope of this power, the navigability challenges created by the shadow system would remain. ASIC's exemptions power (as proposed and discussed below), could be used as an alternative mechanism to retain the benefits of these powers whilst eliminating many of their issues.

3.2. Exemptions

The ALRC has proposed removing ASIC's existing powers to grant exemptions from obligations in Chapter 7 of the Act by regulation or other legislative instrument. We support this Proposal with Proposal A10 to be enacted in its place.

4. PROPOSAL A10

ASIC's power to grant exemptions from Chapter 7 is essential to the operation of an effective legislative regime. The power ensures financial services legislation is fit for purpose, in line with industry standards of practice and adaptable to innovation and growth.

The ALRC has proposed amending the Corporations Act 2001 to provide a sole power to create exclusions and grant exemptions from Chapter 7 of the Act. These exclusions and exemptions are to be contained in a consolidated, thematically organised legislative instruments as shown in Figure 10.1 and Appendix E and described at paragraph 10.118 of the Report. This structure would provide much needed simplification by improving the readability and navigability of exclusions and exemptions.

We are cautious as to any reframing of the exclusions and exemptions powers which would result in a narrowing of its scope. The power in its current form provides much desired flexibility for advancements in financial technologies, business practices and market developments.

We note that paragraph 10.32 of the Report, proposes making the exercise of these powers conditional on ASIC providing robust justification by reference to policy and specified criteria. Any criteria should be framed as broadly as possible, or as matters which ASIC may consider. This would preserve the existing flexibility, provide clarity to applicants and ensure a proper exercise of power.

Alternatively, we consider that a trigger for Parliamentary or Ministerial review could be enacted. It is our position that this would:

- preserve the existing flexibility afforded to ASIC
- create additional checks and balances on ASIC's power
- provide scope for timely legislative reform if the provision is no longer fit for purpose or fails to account for market movements
- minimise exemption requests by addressing as opposed to managing their cause.

5. QUESTION A11

The ALRC has asked whether:

a. the *Corporations Act 2001* (Cth) should be amended to insert a power to make thematically consolidated legislative instruments in the form of 'rules'
b. any such power should be granted to ASIC.

5.1. Thematically Consolidated Rules

The ALRC has questioned whether complexity could be reduced through the creation of thematically consolidated rules. The rules are proposed to be in the form of one or more self-contained legislative instruments. They will not amend, vary or modify the Corporations Act 2001, but will instead contain the prescriptive details and particulars which currently spread across the legislative framework.

We agree with the ALRC's assessment that these rules, 'could greatly improve accessibility, transparency and scrutiny of the rule-making power' (para 10.96). It is our position that the proposed rules would draw a clearer distinction between matters of policy and matters of an operational or technical nature required to give the law efficacy.

We welcome the ALRC's Proposal. The consolidation of these matters in the form of rules would give the law efficacy, create greater checks and balances, and enhance stakeholders' navigation and comprehension of the law.

5.2. Granting of Power

We believe the rule-making power, if and when adopted, should vest in ASIC. As the industry regulator, ASIC has considerable industry and market insight. ASIC can anticipate and rapidly respond to new and unique business models, changing industry practices and financial technologies. Its position allows it to do so with an understanding of the legal limitations and implications of proposed rules and understanding of their practicality.

In exercising this power, it could also be beneficial to import a requirement for consultation. It is our position that this requirement should exist only for matters which extend beyond a minor, technical nature. To retain the existing efficiencies, it may be appropriate for this consultation to occur through a dedicated advisory body, and not the public at large.

6. ADDITIONAL COMMENTS

6.1. Non-key Obligations

Clause 10.81 of the Interim Report argues that obligations which:

- result in criminal or civil penalties and key obligations that are generally applicable should appear in the Act
- do not result in criminal or civil penalties should be situated in legislative instruments.

The inclusion of key obligations in the Corporations Act 2001 would be a positive change. It would improve accessibility of the law and reduce unnecessary complexity, which is otherwise compounded by the segregation of obligations across the legislative framework. However, if only some obligations are included in the Act whilst others are not, the following risks present:

- AFS Licensees may fail to grasp the full breadth and scope of their obligations.
- another layer of complexity may be added to an already challenging framework.

As explained at paragraph 10.81 of the Report, non-key obligations will continue to be situated in legislative instruments. It's our understanding that practically, the AFS Licensee may then need to consult the Corporations Act 2001, the Corporations Regulations 2001, the proposed Rules, consolidated legislative instruments for exemptions, and other legislative instruments containing non-key obligations.

Consideration may be given as to whether non-key obligations could be included in either the legislation or the proposed rules. Alternatively, it would be useful to include links to the instruments in the Act or the Rules.

6.2. Navigability

For a law to be effective, it must be accessible to those expected to comply. To further simplify the existing legislative framework, we believe that a legal database could be created to aid navigation. This database could be similar to the database maintained by the Australian Taxation Office which allows users to access law, interpretations and policy through the one system. Ideally, users would be able to search by key words or phrasing, time periods or categorisation.

The database is thematically organised and contains a linkage tree to further aid navigation. It would provide a consolidated source for financial service laws (including regulations, rules and instruments) and aid in navigability and simplification of the framework.

PERSONAL ADVICE AND GENERAL ADVICE

1. THE PROPOSALS

This submission has been prepared in response to Proposals A13 to A15.

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2. OVERVIEW

Chapter 11 of the Report makes a number of proposals to simplify, clarify and improve the Corporations Act 2001 definition of 'financial product advice'.

To relay the current view of the Financial Services Council ('FSC'), the existing framework consists of 9 different definitions of advice, such as 'intra-fund advice', 'strategic advice', and 'scaled/limited advice', which are confusing regulatory terms that do not resonate with consumers. The current framework needs a regime in which an advice provider either provides financial advice or does not, with all advice considered personal advice except where it is simply not.

As outlined in the Report from paragraph 11.9 through to paragraph 11.22, the terms 'financial product advice', 'personal advice' and 'general advice' are interconnected but also possess their own individual meanings. These meanings are contextualised by a retail consumer's understanding of each of the terms, and by the technical understanding adopted by professionals complying with ASIC's regulatory guides.

The term 'financial product advice' and its two subcategories ('general advice' and 'personal advice'), are defined in s 766B of the Corporations Act 2001. Section 766B(1) provides that for the purposes of Chapter 7 of the Corporations Act 2001, financial product advice means a recommendation or a statement of opinion, or a report of either of those things, that:

(a) is intended to influence a person or persons in making a decision in relation to a particular financial product or class of financial products, or an interest in a particular financial product or class of financial products; or
(b) could reasonably be regarded as being intended to have such an influence.

Section 766B(2) further describes two types of financial product advice, being 'general advice' and 'personal advice'.

3. PROPOSALS A13 & A15

Proposals A13 and A15 recommend amending the Corporations Act 2001 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
(c) incorporate relevant elements of the current definition of 'financial product advice' into the definitions of 'general advice' and 'personal advice'
(d) replace the term 'general advice' with a term that corresponds intuitively with the substance of the definition

The ALRC's broad position is that the financial services legislative and regulatory frameworks are becoming increasingly complex and intricate. The three terms under review require significant skill and time for regulated persons to understand and comply with.

Whilst the inclusion of the three terms may of originally been intended to provide clarification to financial advice providers, the practical reality of the current trichotomy provides no further clarification or practical use and, as the report has accurately identified, only furthered complexity unnecessarily. Again, as identified in the report, the overlap of "financial product advice" over the top of "general advice" and "personal advice" pertains no practical value to professionals intending to administer such advice or in better safeguarding an interest or standard of the consumer.

Under the Corporations Act 2001, two primary questions arise:

1. firstly, has financial product advice been provided?
2. secondly, if financial product advice has been provided, is it general or personal in nature?

Section 766B(4) provides that general advice is financial product advice that is not personal advice. The Corporations Act 2001 does not seek to define general advice beyond this. The current structure of s 766B, including the vague practical distinction between 'general advice' and 'personal advice' has created significant and unnecessary confusion for industry professionals. As demonstrated recently by the High Court in *Westpac Securities Administration Ltd & Anor v ASIC* [2021] HCA, navigating and complying with the advice provisions is challenging for even highly experienced advisors.

The ALRC's Proposals would immensely improve the readability and navigability of s 766B by reducing the use of interconnected definitions, but may not fully address the issues created by s 766B.

The FSC in White Paper on Financial Advice (2021) proposed creating a clearer distinction between personal advice and general advice. We believe this approach should be followed, with the adoption of clear, practical definitions, incorporating the commercial realities of financial product advice.

4. PROPOSAL A14

Proposal A14 recommends that section removing from the definition of 'financial service' from the term 'financial product advice' in s766A(1) of the Corporations Act 2001, and substituting it with 'general advice'.

The Proposals collectively would address the inconsistency between the use of the term 'Financial Service' in the ASIC Act and the Corporations Act 2001. This inconsistency reduces the readability, cohesiveness and navigability for stakeholders. If the definitions of 'personal advice' and 'general advice' in the ASIC Act mirrored the definitions for those terms under the Corporations Act 2001, this would create greater cohesion across the legislative framework.

5. THE RETAIL CLIENT

The FSC's White Paper on Financial Advice (2021) raises the issue of complex regulatory frameworks increasing costs of advice for retail consumers. It is important to consider the impact of any changes made to the definition of "personal advice", especially in the context of increasingly accurate and scalable information and data technologies which can be leveraged.

Reforms to the consumer protection framework over the last decade have generated an advice process driven by compliance, not necessarily in the best interests of individual consumers. This compliance-driven process is used to demonstrate that the law has been followed, rather than to demonstrate value to consumers.

Reducing the complexity and prescriptive compliance driven details of advice will in effect reduce the cost of advice.

6. CONCLUSION

Principles-based regulation can be distinguished from rules-based regulation; it does not necessarily prescribe detailed steps that must be complied with, but rather sets an overall objective that must be achieved. In this way, principles-based regulation seeks to provide an overarching framework that guides and assists regulated entities to develop an appreciation of the core goals of the regulatory scheme.

Any proposed legislative change codifying a holistic, principles-based approach from the Regulator would be an ideal change for the industry and its consumers. The approach must be clarified and simplified to prevent litigation, regulatory intervention and reduce costs for the consumer. A principles-based regime should support compliance as the benchmark by which financial advice delivery should be judged.

DEFINITION OF 'RETAIL CLIENT' AND 'WHOLESALE CLIENT'

1. THE QUESTIONS

This submission has been prepared in response to Questions A16 and A17.

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2. QUESTION A16

Question A16 relates to the product value and the asset and income tests under s 761G of the Corporations Act 2001. The ALRC has asked if the definition of 'retail client' in s 761G of the Corporations Act 2001 be amended:

1. to remove subsections (5), (6), and (6A), being provisions in relation to general insurance products, superannuation products, RSA products, and traditional trustee company services; and
2. to remove the product value exception in sub-s (7)(a) and the asset and income exceptions in sub-s (7)(c); or
3. in some other manner?

2.1. The Tests under s 761G(7)(a) and (c)

The quantitative value thresholds for these tests were determined in 1991. The tests have not since been updated to reflect inflation or current market conditions. We also note that an investor's ownership of their family home continues to count towards the assets and income test under s 761G(7)(c) of the Act.

The ALRC should review and update these monetary thresholds to align with the current financial climate, and consider excluding the family home from the assets and income test. We believe this would limit the number of people that may be defined as 'wholesale' clients and have a proportional increase in the number of clients being characterised as 'retail', resulting in greater protections being provided under this characterisation.

2.2. Investor Protection

An AFS Licensee should not be required to provide 'wholesale' clients with further protection, especially if the Licensee is only authorised to provide general advice under their licence. 'Wholesale' clients should be held to a higher-standard and have greater responsibility in ensuring they understand their position as a 'wholesale' client and the financial investment they are entering into. As previously stated, under the updated product value and asset and income exceptions, these 'wholesale' clients have the financial ability to access specialised financial advice that would allow them to understand the risks associated with being characterised as a 'wholesale' client.

We believe the recommendations put forth by the ALRC for the removal of the quantitative tests in s761G(7)(a) and s761G(7)(c) that characterise individuals as 'wholesale' clients would have a negative effect on the next generation of investments within Australia. The Proposals have the potential to stifle growth within the industry by further narrowing the scope of to whom Licensees may offer their products and services.

It should be noted that recognition of wholesale investors based on a quantitative approach is consistent with many overseas jurisdictions recognised by ASIC as having comparable financial service legislation for the purposes of granting Foreign Financial Service Provider (FFSP) relief.

This allows Australia to continually remain competitive on a global scale for commercial development and innovation.

3. QUESTION A17

The ALRC has asked: what conditions or criteria should be considered in respect of the sophisticated investor exception in s 761GA of the Corporations Act 2001?

The ALRC has suggested the potential of introduction of a subjective test that would be administered by the industry (as opposed to the current test which is administered by the AFS Licensee). Our position aligns with the disadvantages outlined by the ALRC. We believe that administering a subjective test increases the liability of AFS Licensees and intermediaries which would result in a cautious approach being taken, and few investors being characterised as a 'wholesale' client through the 'sophisticated investor' test. The introduction of a subjective test of this kind results in greater inefficiencies and an increase in workload for AFS Licensees and intermediaries, as they are required to assess whether the potential 'wholesale' investor meets the subjective elements of the 'sophisticated investor' test. We believe the end result will be an inferior service than what is currently provided.

The ALRC has also suggested introducing a rating scheme for complex products utilising an objective qualification test. The test would be administered through an independent body that would enable an individual to qualify for the 'sophisticated investor' exception. Whilst we believe an objective test has greater efficacy than a subjective test, we believe the implementation of another regulatory body that administers an additional licence would compound existing complications and confusion. We do not believe the bureaucratic oversight and greater costs would yield proportionate benefits for investors, with additional costs incurred by the industry likely to be passed onto the investor (through an increase in fees).

We recommend adopting a similar approach as suggested under Question A17, through self-certification. The Corporations Act 2001 should provide a simple definition which states the requisites for classification as a 'sophisticated investor'. The criteria under such a definition should express that a client may be considered a 'wholesale' client under the 'sophisticated investor' test if they have the appropriate financial qualifications or experience. The appropriate financial qualifications and experience should align with the AFS licencing requirements for responsible managers, where they are required to hold relevant financial qualifications and/or relevant experience over a set period of time. In addition, upon providing evidence of their relevant financial qualifications and experience, the 'sophisticated investor' should be required to acknowledge the risks associated with being characterised as a 'wholesale' client. This approach places the onus and responsibility upon the investor to prove they are a 'sophisticated investor' through self-certification. The criteria would allow the investor to assume the risks of 'wholesale' classification once they are aware and fully informed and aware of the risks, and have determined that the benefits of the wholesale investment outweigh these risks.