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Australian Law Reform Commission

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Dear Commissioners,

Australian Law Reform Commission's Review of the Legislative Framework for Corporations and Financial Services Regulation

Thank you for the opportunity to make a submission to this inquiry.

References in this submission to 'Interim Report' are to Australian Law Reform Commission, '*Financial Services Legislation: Interim Report A*' (ALRC Report 137) November 2021.

This submission is structured as follows:

Part A addresses certain recommendations and questions in the Interim Report.

Part B has commented upon particular proposals in the Interim Report.

Part A

Our comments in Part A are directed to certain recommendations and questions in the Interim Report that deal with the architecture of the financial services provisions (particularly Chapter 7) in the *Corporations Act 2001*. Noting that the Commission's terms of reference are framed by reference to those provisions, much of what is said in the Interim Report has implications for the broader architecture of the Act and the following comments are made with that in mind.

Recommendation 7

The Corporations Act 2001 (Cth) should be amended to include a single glossary of defined terms.

Recommendation 8

Section 7 of the Corporations Act 2001 (Cth) should be replaced by a provision that lists where dictionary provisions appear and the scope of their application.

We agree with these recommendations subject to the following comments. The first comment may appear to be pedantic but points to a possible source of confusion. The use of the term 'dictionary' in the Act is inaccurate. While some entries in s 9 (and other sections throughout the Act) do define the meaning of key words and phrases, others simply explain the scope or intended usage of word or phrase. One example (which is noted in the Interim Report) is the 'definition' of agency to mean

'an agency, authority, body or person'. Another example is the 'definition' of 'corporation' in s 57A which lists the types of corporate entity that are and are not included within that term for the purposes of the Act. We submit that the proposed idea of a 'glossary', instead of 'dictionary' is preferable.

Secondly, [5.4] of the Interim Report suggests adoption of the principle that each word and phrase should be used with the same meaning throughout an Act, and throughout all delegated legislation made under that Act. While such a principle may have utility in a statute that has a single focus and point of application, it is difficult to see how it could be adopted in an Act as diverse as the *Corporations Act 2001*. The Act has a range of different purposes and applications including the registration of corporations, matters of general corporate governance (such as directors' duties and shareholders' remedies), financial reporting, external administration and winding up, takeovers, managed investment schemes, and financial services. It has different aims: prescribing and regulation conduct; setting standards; facilitating corporate conduct (contracting) and providing remedies. It is unsurprising that these different purposes will require similar words to have different or varied meanings. Paragraph 5.12 of the Interim Report lists some examples. Another example is the word 'officer' which is defined in s 9 but then given varied definitions in Chapter 5 External Administration (see ss 416 and 530A(7)). One way to address this, and adhere to the principle of consistent meaning, would be to separate Chapter 7 from the *Corporations Act 2001*. We note that this possibility has been floated in ALRC consultations; while this idea is supported by one author of this submission (Professor Bottomley), it is not supported by the other (Professor Spender).

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?*

Moves to simplify the legislation and address problems of complexity are based on assumptions about who uses the Act (and Chapter 7 in particular) and the purposes of that use. We have no clear data on who the users are, nor the purposes for which they use the Act. We suggest that this is a question that requires empirical investigation. Intuitively we can guess that the category of likely users includes professional advisers (lawyers and others); directors and company officers (from large and small companies); regulators engaged in compliance and enforcement activity; policy makers; drafters and the courts. But without a more informed picture, any changes to the architecture of the Act must rely on assumptions. This is actually acknowledged in [6.109] of the Interim Report, which states that '[b]etter data about the users of legislation, both generally and in regard to particular Acts, would help legislative drafters make informed decisions about their audience.' To be clear, this is not just a question of improving the accessibility and navigation of the legislation; it is also aimed at achieving a better understanding of its functional use.

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?*

With regard to Question A11(a), we agree that such an amendment should be made to the Act. Exemptions, exclusions and other forms of 'notional legislation' should be situated at a single layer of the legislative hierarchy and contained in a single consolidated legislative instrument.

With regard to Question A11(b), in our view, corporate law in general, and financial services regulation in particular, is an area where rule making by a specialist agency such as ASIC is unavoidable and necessary for the proper operation of the corporate and financial services system. That said, the key tenets of the rule of law and the separation of powers require that this discretionary agency power should be exercised in a manner that is transparent, accountable and accessible. There is no single way of achieving those goals; a multi-pronged approach is needed. The proposal to consolidate all forms of 'notional legislation' into a single body of 'rules' is one important part. In this context we also note the creation of the Financial Regulator Assessment Authority (FRAA) in 2021, charged with reporting biennially on the effectiveness and capability of ASIC (and APRA).

In addition to this oversight of ASIC, we submit that there should be regular review of the effectiveness and capability of the legislation (primary and delegated). This task could be performed by a re-constituted version of the Corporations and Markets Advisory Committee (CAMAC). Whereas CAMAC's capacity was limited to responding to references for advice on corporate law reform, a newly created body could be given the responsibility of regular reviews of Chapters or Parts of the *Corporations Act 2001*.

Finally, consideration should be given to the mandatory sunsetting of instruments such as ASIC orders that are intended to have temporary effect. The length of time prior to sunsetting would require close consideration, but it should be considerably shorter than the 10 year sunset requirement specified in the *Legislation Act 2003*.

Part B

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'

We agree with this proposal and note that the Interim Report comments on the connection between the definition of financial product and other wide-ranging definitions in the *Corporations Act 2001* such as the definition of security/securities and, to a lesser extent, derivative. Therefore we anticipate that further work will need to be undertaken on the definition of these terms to clarify their operation across the *Corporations Act 2001* to ensure the integrity of these definitions to support the various policy settings in the *Corporations Act 2001* e.g. Chapter 6D.

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);*
> *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);*
> *d. remove the incidental product exclusion by repealing s 763E of the Corporations Act 2001 (Cth);*
> *e. insert application provisions to determine the scope of Chapter 7 of the Corporations Act 2001 (Cth) and its constituent provisions; and*
> *f. consolidate, in delegated legislation, all exclusions and exemptions from the definition of 'financial product' and from the definition of 'financial service'.*

We agree that this suggested implementation of Proposal A3 will certainly simplify the definitions of 'financial product' and 'financial service'. As regards the point made above regarding the definition of 'securities' and 'derivative' we note that these terms are a specific inclusion in section 764A. Although we agree with the suggestion to remove specific inclusions from the definition of financial product in Proposal A4(a) the definition does have some 'structural elements' insofar as it provides an express reference to these pivotal concepts. They of course can be placed elsewhere but it is worth noting. We agree with the other elements of this proposal which would allow implementation of Proposal A3 and simplify the definition 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)).*

We agree with this proposal and note that the current definitions in ss 763B, 763C, 763D *Corporations Act 2001* (and their *ASIC Act* equivalents) do not progress the interpretation of the general definition of 'financial product' in section 763A.

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).

We agree with Proposal A6(a), however we have some hesitation about Proposal A6(b) and (c).

We consider that inserting a new paragraph which includes 'obtains credit' in section 763A(1) *Corporations Act 2001* and the comparable provision in the *ASIC Act* may potentially conflate the regulation of financial and credit products. Traditionally there was a distinction drawn in Australian law between the protection of investors and consumers (including consumers of credit products). (We recognise that the word 'consumers' is adopted in the Interim Report to refer broadly to consumers of financial products which may include investors).

The regulation of the activities of investors and consumers has increasingly converged but has not been completely eliminated because of the underlying policy that investors and comparable consumers of financial products (such as derivatives) assume greater risk than consumers. This is evidenced by *Sons of Gwalia Ltd v Margaretic* (2007) 231 CLR 160 and the subsequent legislative response to that judgment although there are other resonances of it in Australian law. There is some confusion about the relationship between and delineation of financial and credit products as demonstrated by the litigation and ultimately the High Court judgment in *International Litigation Partners Pte Ltd v Chameleon Mining NL* (2012) 246 CLR 455, [2012] HCA 45. Aspects of this litigation are discussed in the Interim Report at [7.111]. Professor Spender's analysis of the High Court judgment may be found at 'Wavering Alternations of Valour and Caution: Commercial and Regulatory Litigation in the French CJ High Court' (2013) 2 *Journal of Civil Litigation and Practice* 111 at 127 ff.

Although we consider that Australian law is predicated upon the view that investors assume greater risks than consumers, Australian people often become investors because of the 'financialisation' of modern life – people are subtly compelled to become financially self-reliant by what some commentators call the emergence of the 'financial citizen'. This issue is discussed by Professor Bottomley in his book *The Responsible Shareholder* (Edward Elgar Publishing, 2021) at pages 32-33 and 66.

In view of the above, if the definition of financial product includes a definition which substantially reflects a credit arrangement this may lead to consequential unintended effects.

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.

We agree with this proposal and note the Interim Report states at [9.1.27] that the relevant standard should be developed through consultation. The Interim Report provides a workable example of an outcomes-based standard of disclosure in this paragraph by 'reframing the obligation as a requirement to take reasonable steps designed to ensure that a reasonable consumer, and their financial adviser where appropriate, would understand the key risks, costs, and benefits of the product at the time of investment.'

Most observers of the disclosure regime in Chapter 7 would say that it has failed to deliver the policy that underpinned its introduction based on the recommendations of the Wallis Report (particularly the consumer protection aspect) and this amendment would allow the disclosure regime to work more effectively.

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 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.

We agree with these two proposals and note that the use of the terms 'general advice' and 'personal advice have led to considerable obfuscation and this obfuscation should be remedied. Anecdotally, the labelling encourages the provision of personal advice under the label of 'general advice' by some financial advisers that erodes the operation of the consumer protection provisions in Chapter 7 which flow from the provision of personal advice. The Interim Report indicates that some work will need to be done on substitute terminology and we see at [11.77] that general advice could be termed something like 'non-personalised recommendation' or 'non-tailored recommendation'. We also note that this issue is being dealt with generally by the Treasury in the Quality of Advice Review.

Proposal 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?*

We will comment on paragraph a (ii) of this proposal. We wholeheartedly agree with this proposal. The product value exception and the asset and income exceptions in sub-s (7)(c) are so out of date as to potentially operate very adversely to people who would otherwise fall within the definition of retail clients. When teaching this area, we often comment that the values stated in the asset and income exceptions are below the common commitments undertaken by people in residential mortgages in Australia. This demonstrates the problem, which should be rectified.

Proposal A17

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

We consider that the sophisticated investor exception in section 761GA *Corporations Act 2001* should either be amended or removed. There are many definitions in Chapter 7 which add

additional criteria to the baseline definition of wholesale client. This causes confusion and, in our view, unnecessary proliferation of exceptions to the category of retail client which could readily be brought within the rubric of a wholesale client. In this respect, we note the New Zealand approach discussed in the Interim Report at [12.95] which has created two categories of retail and wholesale client. However, it may not be appropriate to adopt the New Zealand approach in its entirety and the exemption in section 708(10) *Corporations Act 2001* must also be taken into account when considering the operation of the categories.

Proposal A18

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

Proposal A19

What norms should be included in such an objects clause?

We agree that interpretation of the provisions of Chapter 7 would be enhanced by the insertion of an objects clause which states certain norms. As to which norms, we note that the Interim Report refers to the Eggleston principles in Chapter 6 *Corporations Act 2001* and we agree that section 602 *Corporations Act 2001* provides a model although there is some tension in that provision between the so-called Eggleston principles stated in s 602(b)-(c) and the purpose that was inserted in s 602(a) by CLERP in 2000. This is discussed in S Bottomley et al *Contemporary Australian Corporate Law* (Cambridge University Press, Second edition, 2021) at pages 569-570.

The Interim Report at [13.36]ff refers to the norms stated by the Hayne Royal Commission (HRC) as a possible blueprint for an objects clause in Chapter 7. We consider that the UK FCA Handbook Principles for Business - discussed in the Interim Report at [13.28] and stated in the Table 13.1 –have greater utility than the norms stated by the HRC. The Interim Report notes that one of the HRC norms – 'obey the law' – is redundant: see [13.37]. Similarly the 'act fairly' HRC norm is difficult to implement as an interpretive tool compared with the '[w]hen acting for another, act in the best interests of that other' HRC norm which is reflected in many of the conventions, practices and rules stated in Chapter 7.

One consideration about stating norms and possibly inserting an objects clause into Chapter 7 is that this chapter also regulates market conduct in Parts 7.1 to 7.5 A. This area generates less case law as a consequence (to some extent) of the regulatory relationships within the markets. When framing norms for an objects clause in Chapter 7 one would need to consider this aspect of the chapter as well as the norms that apply to financial products and financial services.

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.*

We wholeheartedly agree with this proposal and note that replacement of the word 'efficiently' with 'professionally' would allow the case law in this area to more effectively converge with the general case law on occupational regulation in Australia. This is already articulated in the case law (see for example the discussion in S Bottomley et al *Contemporary Australian Corporate Law* (Cambridge

University Press, Second edition, 2021) at pages 531-532) and is consistent with the increasing professionalisation of financial advice.

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

We agree with this proposal.

Proposal 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?

We wholeheartedly agree with this proposal. There is considerable confusion caused by the relationship between ss 961B(2)(a)–(f) and 961B(2)(g) of the *Corporations Act 2001* that would be resolved by this amendment. We also consider that repealing ss 961C and 961D would facilitate the interpretation of s 961B(1) and (2). There may need to be some further work on section 961G because it is not exactly clear what its relationship is to s 961B. Section 961G has been explored in the case law but, in the view of the authors, the ambit of its operation is still unclear.

Yours sincerely,

Emeritus Professors Peta Spender and Stephen Bottomley