Law Council
OF AUSTRALIA

Interim Report A: Review of the Legislative Framework for Corporations and Financial Services Regulation

Australian Law Reform Commission

11 March 2022

Telephone +61 2 6246 3788 • *Fax* +61 2 6248 0639
Email mail@lawcouncil.asn.au
GPO Box 1989, Canberra ACT 2601, DX 5719 Canberra
19 Torrens St Braddon ACT 2612
Law Council of Australia Limited ABN 85 005 260 622
www.lawcouncil.asn.au

Table of Contents

About the Law Council of Australia

The Law Council of Australia exists to represent the legal profession at the national level, to speak on behalf of its Constituent Bodies on national issues, and to promote the administration of justice, access to justice and general improvement of the law.

The Law Council advises governments, courts and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas and maintains close relationships with legal professional bodies throughout the world. The Law Council was established in 1933 and represents 16 Australian State and Territory law societies and bar associations and Law Firms Australia, which are known collectively as the Council's Constituent Bodies. The Law Council's Constituent Bodies are:

- Australian Capital Territory Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar
- Law Firms Australia
- The Victorian Bar Inc
- Western Australian Bar Association

Through this representation, the Law Council effectively acts on behalf of more than 90,000[1] lawyers across Australia.

The Law Council is governed by a board of 23 Directors – one from each of the constituent bodies and six elected Executive members. The Directors meet quarterly to set objectives, policy and priorities for the Law Council. Between the meetings of Directors, policies and governance responsibility for the Law Council is exercised by the elected Executive members, led by the President who normally serves a 12 month term. The Council's six Executive members are nominated and elected by the board of Directors.

Members of the 2022 Executive as at 1 January 2022 are:

- Mr Tass Liveris, President
- Mr Luke Murphy, President-elect
- Mr Greg McIntyre SC, Treasurer
- Ms Juliana Warner, Executive Member
- Ms Elizabeth Carroll, Executive Member
- Ms Elizabeth Shearer, Executive Member

The Acting Chief Executive Officer of the Law Council is Ms Margery Nicoll. The Secretariat serves the Law Council nationally and is based in Canberra.

1 Law Council of Australia, *The Lawyer Project Report*, (pg. 9,10, September 2021).

Acknowledgement

The Law Council of Australia acknowledges the assistance of its Business Law Section and the Superannuation Committee of its Legal Practice Section in the preparation of this submission. The Law Council is also grateful for the contribution of the Queensland Law Society.

Executive Summary

1. The Law Council of Australia (**Law Council**) and its Business Law Section (**BLS**) is pleased to make this submission in relation to *Financial Services Legislation: Interim Report A* (**Interim Report**) of the Australian Law Reform Commission's (**ALRC**) Review of the Legislative Framework for Corporations and Financial Services Regulation (**Inquiry**). This submission offers general observations as to the scope and nature of the Inquiry, before specifically responding to each of the Interim Report's Proposals and Questions.

2. The Law Council commends the work the ALRC has done to date in consulting a wide array of stakeholders and mapping the problems with Australia's financial services legislation. The Law Council and its membership are supportive of measures to appropriately simplify and streamline the *Corporations Act 2001* (Cth) (**Corporations Act**), particularly Chapter 7, to improve regulatory coherence and certainty for users of the legislative framework.

3. As set out in this submission, the Law Council suggests that the ALRC may wish to further consider the 'big picture' of what could be achieved by this Inquiry, noting that the current Terms of Reference may be unduly restrictive. In particular, the Law Council notes that some proposals in the Interim Report may involve policy rather than purely technical considerations. With this in mind, and as set out in more detail throughout this submission, the Law Council:

   - notes there is a broader design problem with Chapter 7 of the Corporations Act, and therefore most of the problems the ALRC has identified are unlikely to be fixed by way of the technical changes proposed and allowed for in the Terms of Reference;
   - recommends taking steps in the interim, which are uncontroversial and practical, to limit some of the obvious difficulties with Chapter 7 of the Corporations Act;
   - supports consistency and co-location of definitions and terminology, at a minimum, across the Corporations Act and the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**);
   - does not support enacting a uniform definition of the terms 'financial product' and 'financial service', nor removing 'makes a financial investment', 'manages financial risk' and 'makes non-cash payments', as these definitions help to generate certainty;
   - supports implementing an outcomes-based standard of disclosure, while recognising there are broader problems with Part 7.9 of the Corporations Act to be acknowledged and addressed;
   - does not support the removal of powers to grant exemptions from obligations or notionally amend provisions of Chapter 7;
   - strongly supports the idea of rules, in the form of a thematically consolidated legislative instrument, combining all financial services-related regulations and other modifications, provided that the power to make and amend the rules is not solely vested in the Australian Securities and Investments Commission (**ASIC**);
   - supports the development of a mechanism to improve the visibility and accessibility of notional amendments to the Corporations Act made by delegated legislation;

- submits that there is a broader problem regarding the definition of 'financial product advice' which necessitates the removal of the concept of general advice and the recasting of the concept of financial advice;
- does not support abandoning the net assets and gross income tests and instead recommends making appropriate refinements to these tests;
- does not support the removal of the identified prescriptive requirements in subsection 912A(1) of the Corporations Act; and
- supports the amendment of subsection 961B(2) and the repeal of sections 961C and 961D of the Corporations Act.

Scope of the Inquiry

4. The Law Council commends the extensive consultation that the ALRC has undertaken to date as part of the Inquiry by approaching a broad group of stakeholders through a variety of methods and allowing reasonable timeframes to respond. The Law Council looks forward to continuing to engage with the ALRC as the Inquiry progresses.

5. Contributors to this submission are quick to acknowledge the outstanding work by the ALRC in mapping the problems with Australia's financial services legislation. While there is a level of concern with what is achievable within the Terms of Reference, the Law Council recognises that the data and material produced thus far by the ALRC has been a worthwhile exercise and serves to underscore the challenges faced by those interacting with this legislative scheme.

Considering a principles-based approach

6. The Law Council appreciates the desire for the ALRC to identify and address legislative approaches that are particularly problematic in relation to corporations and financial services regulation. However, it may be that there is a need to take a step back before taking any further steps forward, in order to look at the 'big picture' of what could be achieved by this Inquiry. The Law Council acknowledges that the Terms of Reference to the Inquiry may not allow for such an approach.

7. As an initial step, the Law Council suggests that a decision be articulated as to whether a key focus on the principles already embodied in the law should be taken. This is important because it will impact the way in which the definitions – which are the focus of the Interim Report – are used.

8. Where appropriate, consideration should be given as to whether the legislative framework would benefit from a clearer focus on overarching core principles. By way of example, in 2018, the Law Council endorsed the core principles identified by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Royal Commission**) in its Final Report,[2] namely:

    - obey the law;
    - do not mislead or deceive;
    - act fairly;

[2] Law Council of Australia, *'Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (31 October 2018) <https://www.lawcouncil.asn.au/resources/submissions/interim-report-of-the-royal-commission-into-misconduct-in-the-banking-superannuation-and-financial-services-industry> [43].

- provide services that are fit for purpose;
- deliver services with reasonable care and skill; and
- when acting for another, act in the best interests of that other.

Implementing a thematic structure

9. The Law Council submits that the ALRC should consider how the Corporations Act could be reorganised into a sensible thematic structure, which it currently lacks. This process could be done before further work is undertaken on definitions and hierarchy, noting that renumbering individual sections could be deferred to a later stage.

10. In the Law Council's view, it would be ideal to simplify the structure of the Corporations Act as much as possible and then have a separate 'rule book' of delegated legislation which is organised in a more logical and structured manner than the current Chapter 7 of the Corporations Act.

11. The Law Council notes that Chapter 7 attempts to cover a broad range of areas. In particular, the Law Council is aware that a problem has arisen from blurring the line between financial consumers and retail investors, and mixing the (quasi-prudential) regulation of market operators and intermediaries with the consumer protection laws. Significantly, most of Chapter 7 is not directed to consumer protection. Consolidating all consumer protection provisions into a separate rule book topic, that is not intertwined with other types of protection, could be beneficial to the regulated population.

Technical vs policy changes

12. The Law Council notes that the Inquiry intends to recommend technical changes to streamline the legislation, as opposed to recommending policy changes which would alter its substantive content. However, the excellent work done to date by the ALRC demonstrates that the fundamental problems with the Corporations Act – and with Chapter 7 in particular – cannot be solved 'within the context of existing policy settings' as required by the Terms of Reference. These problems have been identified over the course of many years by experienced practitioners, the courts and Commissioner Hayne. Unless 'policy' is very broadly conceived and clearly defined, the current Terms of Reference do not allow for these inherent problems in the legislative regime to be addressed and rectified.

13. The Law Council considers that some proposals in the Interim Report may involve policy rather than purely technical considerations (e.g. the removal of certain limbs of the wholesale client test) and should be identified as such so that appropriate consultation and proper policy debate with appropriate stakeholders can be undertaken.

The Wallis Report

14. The Law Council acknowledges that there was a deliberate 'policy' decision in the 1997 Report on the Australian Financial System (**Wallis Report**) to use a legislative framework for Chapter 7 of the Corporations Act that adopted broad, overinclusive definitions and requirements which would sweep up disparate products, services and transactions. This was decided on the basis that the framework would be customised over time through subordinate legislation, exemptions and modifications to exclude things that ought not to be caught and make the regulations work for each situation.

15. The Law Council submits that tinkering with perimeter definitions, including by making them less precise, does not address the fact that the exemptions and exceptions criticised by Commissioner Hayne are inherent features of this legislative design. The same applies to removing the power of ASIC to customise the rules for new or anomalous situations. While physically locating exemptions and exceptions in one place may help with navigability, it will not resolve the underlying issue.

16. The Law Council is not advocating for a return to product-by-product or service-by-service financial sector regulation. However, if the approach in the Wallis Report is to be retained in areas currently captured under Chapter 7 of the Corporations Act, this approach should be properly reviewed to take account of differing policy considerations within the overarching framework and its relationship with other statute and licensing regimes for the financial sector.

Navigating Chapter 7 of the Corporations Act

17. The Law Council commends the significant work undertaken by the ALRC to date in order to identify the navigational challenges within Chapter 7 of the Corporations Act, and investigate ways to make it more accessible for the general population and first-time users, rather than just specialists.

18. The Law Council notes that a key challenge is the application of Chapter 7 of the Corporations Act to a combination of investment products and consumer products, producing a complex regime that is not well suited to either. As a result, Chapter 7 can perhaps be best described as an intricate and unkempt labyrinth, suffering from dead ends, trip hazards and inadequate signage.

19. It is important to recognise at the outset that the Chapter 7 maze is a product of its history, with its complexity and disjointedness resulting from piecemeal renovations and extensions over time. While most perceived cracks and pitfalls in the maze have been eventually rectified in isolation, its underlying design problems have never been fixed. This means that the time taken, and associated costs, to traverse it, will often be greater than should reasonably be expected, and at times, users can inadvertently become disoriented, lost and frustrated. Importantly, not all explorers have the resources to hire expert guides (i.e. specialist lawyers) to shine a light on the hazards and point out the difficult, narrow passages.

20. The Law Council notes that some parts of the maze are only accessible with a permit (i.e. an Australian Market Licence or an Australian Financial Services Licence (**AFSL**)), but this is not always well understood or recognised. This means that some less experienced explorers will be in these areas while unknowingly in breach of the laws, which is unsafe from a consumer protection perspective.

21. As noted above, however, the Law Council queries whether the Inquiry's Terms of Reference allow for the solving of the substantive challenges in the existing legislative regime. Specifically, starting the redesign work at Chapter 7 may be akin to attempting to refurbish the maze while standing halfway down the path. This may mean that the crucial opportunity to address the fundamental root problems arising from the design of the maze itself will be missed.

22. Most of the identified problems in Chapter 7 cannot be fixed by way of the technical changes envisioned in the Interim Report, such as adjusting definitions or moving rules from subordinate to principal legislation. Rather, there is a much broader design problem which should be promptly addressed, and this can only be done by way of broader policy changes (currently out of scope). In the interim, the Law

Council supports moving forward with a 'spring clean' of the maze as soon as possible to make it easier and safer to navigate.

Possible interim measures

23. The Law Council believes it is worthwhile taking interim steps to limit some of the clear shortcomings of the Chapter 7 maze. 'Small wins', such as removing redundant definitions, are a clear way of addressing obvious difficulties. There are also other steps which can be taken without substantively changing the law which are practical and likely to be uncontroversial. This 'low-hanging fruit' which can be picked relatively simply includes:

    - capturing all definitions in one place (even if a term might have a different meaning in one part of the legislation to another);
    - when a defined term is used, making it clear that it is a defined term (e.g. underline, italicise, asterisk, capitalise or hyperlink so that the definition displays when the term is clicked);
    - consolidating exemptions and modifications into a single legislative instrument by adopting the approach used in the anti-money laundering legislation with the Anti-Money Laundering and Counter-Terrorism Financing Act Rules Instrument 2007 (No. 1) (Cth) (**AML/CTF Rules**); and
    - enabling a person who is looking up a particular section to easily see what exemptions or modifications have been made (e.g. through links).

24. The Law Council also encourages making the publicly available legislation more user-friendly and would welcome public resources being dedicated to this objective. These types of upfront measures would reduce the incidence of future rescue missions for explorers lost in the maze, including those who may have been led down a section of the path that was not safe for them to be using.

Responses to Questions and Proposals

General comments

25. The Law Council has previously advocated for simplification of the Corporations Act, particularly Chapter 7, in order to improve regulatory coherence.[3] The current tangled interaction between principal legislation, codes, regulations and other legislative instruments creates uncertainty and requires unduly technical analysis as to which rules apply.

26. Despite the Inquiry generally focusing on technical instead of policy changes to the legislative framework, the Law Council considers that transitioning provisions will nonetheless be vital to provide industry with sufficient time to implement any changes in detailed compliance systems and processes (and associated computer programming) arising from the final legislative changes.

27. The Law Council recognises that seemingly minor legislative changes may require a substantial period of transition due to the significant 'behind the scenes' consequences for financial services institutions. Further, these systems may still have legacy streamlining and remedial scheduled changes in the pipeline which have arisen from recent legislative changes impacting the financial services industry.

[3] Ibid, [41].

These scheduled changes may require reconsideration, amendment and actioning, in addition to any revisions arising directly from the Inquiry.

28. The Law Council suggests that a generous transition period be provided and that both industry and consumer groups are consulted to ensure a realistic transition period is ultimately adopted. Any transitioning provisions should prioritise and depend upon the timely and early availability of clear regulatory guidance in final form.

Specific responses

Empirical Data

Question A1

29. The Law Council submits it would be useful to map the relationship of the financial services and financial products laws to other financial sector laws. This relationship adds a further level of complexity that is specific to the financial sector, exacerbated by the blurred responsibilities of ASIC and the Australian Prudential Regulation Authority (**APRA**). This is particularly acute in superannuation, where superannuation trustees of large funds must hold an AFSL pursuant to Chapter 7, and a Registrable Superannuation Entity (**RSE**) licence issued by APRA, pursuant to the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**).

When to define

Question A2

30. The Law Council agrees that definitions should be as consistent as possible across the Corporations Act and the ASIC Act at a minimum, and ideally across the whole statute book.

31. The Law Council recognises that definitions serve different functions, and this must be taken into account when designing them. In particular, some definitions mark out the perimeters of regulation, where if an activity is within the definition it is regulated, and if it is outside, it is not. While this type of definition may be undesirable when attempting to simplify legislation, its existence is inevitable, given the nature of the matters being legislated. In accordance with the rule of law that requires that the law be both known and readily available, these definitions should be as clear and detailed as possible as they determine whether a particular law applies.[4] The problems that have plagued the definitions of 'managed investment scheme' and 'derivatives' show how hard this is to achieve, and there is plenty of judicial commentary on definition design in the cases dealing with litigation funding, for example.

32. The Law Council observes that tension in this area consistently arises between open-ended functional definitions that are needed to catch financial innovation (the idea behind Corporate Law Economic Reform Program (**CLERP**) 6 and the *Financial Services Reform Act 2001* (Cth)) and lists of legacy products and services. However, certainty is important, even if expressed as examples of things that are, or are not, within the general definition. Otherwise, it is likely that wasted money and

[4] See, for example the Law Council of Australia, *Policy Statement - Rule of Law Principles* (March 2011), <https://www.lawcouncil.asn.au/resources/policies-and-guidelines/rule-of-law-principles>.

effort will follow from seeking legal opinions on scope that can never be definitive (unless ASIC wants and gets a rulings power).

33. Ideally, definitions are grouped together in one place. This will make it easier to identify the definitions of little or no value, such as definitions of words that have their ordinary meaning, or where the definition does not correspond intuitively to the word. It will also promote consistent and natural language definitions. Where a term might have different meanings in separate parts of the legislation, it would be helpful to see this in the central definitions area, as this avoids the risk of the user seeing one definition and incorrectly assuming it is used consistently throughout the Corporations Act.

Definitions of 'financial product' and 'financial service'

34. The Law Council notes that having specific rules to clarify whether a particular product is a financial product, or whether a particular service is a financial service, generates certainty. Accordingly, there is a concern that simplification could increase uncertainty.

35. In addition, care must be taken to ensure that all the current exemptions and modifications are accurately replicated without substantive change. Alternatively, if there is substantive change as a result of the amendments, there must be a sound policy reason for doing so.

Proposal A3

36. The Law Council notes that the differing definitions of 'financial product' and 'financial service' between the Corporations Act and the ASIC Act reflect, in part, the subject matter and current roles of those Acts within the current legislative regime. In particular, the role of the ASIC Act is primarily to articulate the role and powers of ASIC as a regulator and to address consumer protection laws applicable to the financial services industry.

37. To that end, the broader definition of 'financial product' under the ASIC Act (incorporating credit in Part 2 Division 2 of the ASIC Act, for example) is a reflection of ASIC's jurisdiction under the *National Consumer Credit Protection Act 2009* (Cth) (**NCCP Act**) as well as under the Corporations Act.

38. The Law Council submits that the legislative purpose should drive the definition, not the other way around. In this regard, it could be useful to approach these 'perimeter' definitions from the following perspectives:

- To what should the relevant law apply?
- What 'service' in the financial sector should only be provided by people who are licensed?
- What 'product' should only be sold to consumers with a Product Disclosure Statement (**PDS**)?
- What should be regulated as a gambling product and not as a financial product?

39. The Law Council notes that the conceptual distinction between providing a financial product and providing a financial service is rarely well understood (and is made less clear by the structure of Chapter 7 and blurred by the definitions in the ASIC Act). Generally, 'products' are not regulated for quality in the Australian system and

instead, it is about how, and to whom, they are sold. On the other hand, 'services' are indeed regulated for quality, and this is called conduct regulation.

40. As such, before there is any attempt at redrafting, the Law Council recommends developing an understanding of how collective investments – including most superannuation funds, mutual funds, listed investment companies and exchange traded funds – straddle service and product.

Proposal A4

41. The Law Council is reluctant to support this proposal, as there is value in retaining specific inclusions and exclusions in perimeter definitions, even if they are just examples.

42. If the principle is accepted that giving certainty is important, then the capacity to add or remove things from being deemed financial products or financial services – by regulation or ASIC instrument – is also important and should be retained. This is because innovation in financial products and services moves quickly and waiting for parliament to amend primary legislation is not practicable. The Law Council also recommends that there be a single source of truth about what is deemed in or out under such definitions.

43. The Law Council instead recommends insisting that proper processes, such as consultation, are followed by the person exercising the power, in addition to strict oversight of formal and substantive compliance by departments and agencies with the *Legislation Act 2003* (Cth) (**Legislation Act**).

44. The Law Council notes that Proposal A4(a) would potentially have the effect of changing the range of products that could be considered 'financial products'. For example, a non-interest-bearing bank account is clearly a financial product under the existing law, but the removal of section 764A would make its status less certain.

45. In relation to Proposals A4(b) and (c), a consequence of the breadth of the existing definitions is the need for specific regulations or legislative instruments (which were labelled by ASIC as 'class orders' prior to 2015) including and excluding various products and services from the definitions of 'financial product' and 'financial service' respectively. This is also the result of the unsuitability of Chapter 7's broad approach, namely the attempted 'one-size fits all' regulation of a significant range of non-homogenous products generally.

46. Although there may be a case for rationalising the exemption powers and ensuring that the exemptions are easily navigated, the Law Council does not support the removal of the exemption powers per se. To the extent that the consolidation in delegated legislation (Proposal A4(f)) includes an associated power to update the content of the legislative instrument, the Law Council would be supportive of that proposal. Any such power should include requirements for consultation and be subject to the usual Parliamentary disallowance mechanisms.[5]

47. The AML/CTF Rules are an example of a single legislative instrument that captures exemptions and modifications of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) (**AML/CTF Act**). A separate chapter is created for each exemption and modification topic. This is easier to follow than the current arrangements in place for Chapter 7 of the Corporations Act.

[5] See further detail on this point at Proposal A10.

Proposal A5

48. The Law Council does not support Proposal A5 and does not consider these definitional provisions to be a source of complexity in and of themselves. On the contrary, these provisions clarify and provide certainty to the overarching definitions. The notes which accompany these definitions are also a helpful interpretation aid for practitioners.

49. The Law Council notes that there is a broader question about whether these definitions capture all (and only) financial products conceptually. In the universe of 'products' that have a buyer and seller, there are two hemispheres – financial products (ASIC regulated) and non-financial products (Australian Competition and Consumer Commission regulated). It would be helpful to have improved clarity about where the dividing line sits.

Proposal A6

50. On the face of it, the Law Council agrees that the alignment of the definition of 'credit' under the Corporations Regulations 2001 (Cth) (**Corporations Regulations**) and the ASIC Act with the NCCP Act definition would be a beneficial change that would reduce complexity. However, the treatment of some facilities which currently fall under the definition of credit, but are excluded, would need to be carefully considered.[6]

51. The Law Council notes that credit reporting provisions under the *Privacy Act 1988* (Cth) also contain a definition of 'credit' which does not clearly align with the ASIC Act nor the NCCP Act, and this introduces an additional layer of complexity in the regulation of credit.

52. The Law Council also notes that the scope of the credit provisions is dictated by other provisions, such as sections 5 and 6 of the National Credit Code under the NCCP Act, which means that the alignment of the credit definition pursuant to Proposal A6 would not fully address the identified complexity.

53. The Law Council recommends that care be taken to ensure that each of the current exemptions and modifications are accurately replicated without substantive change. Alternatively, if there is substantive change resulting from the amendments, there must be a sound policy reason for doing so.

Disclosure

Proposal A7

54. The Law Council supports any reduction, or simplification, of defined terms across the Corporations Act. However, it is not clear to some practitioners how this proposal would improve disclosures for consumers or reduce the complexity of disclosure under the current regime. Replacing one defined term for another would not simplify the law nor address its underlying issues.

55. The Law Council considers that amendments to key terms, particularly the use of the term 'preparer', should be considered in light of the liability provisions in Division 7 of Part 7.9 of the Corporations Act, which also uses the terms 'preparer', 'prepare' and related concepts.

[6] See response above to Proposal A3, where the Law Council recommends shaping the definition with an eye to what should trigger operation of the relevant provisions.

Proposal A8

56. The Law Council supports this proposal as a starting point and believes that an outcomes-based standard of disclosure – focused on consumer understanding – will assist in reducing complexity from a responsible person's perspective and will also aid consumer understanding. It would also provide product issuers with a principle of a more commercially intuitive nature by which they can judge their disclosures to consumers, rather than focusing on a swathe of prescriptive requirements set out in the Corporations Act, Corporations Regulations, legislative instruments and ASIC guidance.

57. An outcomes-based approach could be based on identifying some key overriding disclosure principles against which all disclosures are assessed. ASIC's 'Good Disclosure Principles' in Regulatory Guide 168 could be used as a model for identifying such principles.[7] However, the Law Council acknowledges that the standard of disclosure requires determination, and as noted in the Interim report, the Corporations Act currently has several standards.

58. The Law Council notes the ALRC's example in the Interim Report of the relevant standard, which could be an overarching requirement for a product issuer 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.[8] The Law Council considers this principle to be a good working standard, but does not support the suggestion that publishing the reasons for the reasonable steps would be meaningful,[9] as such statements are likely to be formulaic in nature.

59. The Law Council considers that there could be more than one disclosure standard, provided they are consistent. For example, the 'reasonable steps' test mentioned above could apply, while also having a principle that disclosures must be 'clear, concise and effective'. Perhaps a distinction should be drawn between an overarching 'standard' on the one hand, and 'disclosure principles' on the other.

60. The Law Council does not consider, however, that an outcomes-based standard of disclosure is inconsistent with the legislative prescription of minimum content requirements for financial product disclosure. Prescribing minimum content requirements could be satisfied, while the overall test of the effectiveness of disclosure would be assessed by overriding disclosure principles.

61. The content of minimum disclosure requirements would, of course, be subject to differences of opinion. Some matters would be non-contentious, such as being obliged to set out the name, Australian Company Number / Australian Business Number and contact details of the issuer of the document. However, other disclosure requirements (e.g. about product costs) may need to be framed with a sufficient degree of specificity required to give product issuers certainty that they have complied with their legal obligations.

62. The Law Council therefore considers that care should be taken with the identification of minimum content requirements, including those which are articulated in the

[7] Australian Investments and Securities Commission, *Regulatory Guide 168: Disclosure: Product Disclosure Statements (and other disclosure obligations)* (October 2011) <https://download.asic.gov.au/media/5689951/rg168-published-28-october-2011-20200727.pdf> 5.
[8] Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (November 2021) [9.127].
[9] Ibid [9.129].

legislation in a generalised way, because the lack of specificity could lead to ambiguity.

63. There is also a need for greater specificity to be set out in subordinate legislation and regulatory guidance. For example, the environmental, social and governance disclosure requirements and dollar disclosure requirements in paragraphs 1013D(1)(l) and 1013D(1)(m) of the Corporations Act respectively are expressed in a generic fashion. Voluminous ASIC legislative instruments and guidance has evolved and accumulated in these areas, with a view to clarifying what issuers must do to address these disclosure obligations.

Broader problems with Part 7.9 of the Corporations Act

64. The Law Council submits that there are much broader problems with Part 7.9 of the Corporations Act which need to be acknowledged and addressed. These stem from:

- its (illogical) relationship with Chapter 6D;[10]
- the cumbersome rules about delivery of PDSs (based on the 20th century assumption that people were buying financial products through financial advisers and getting paper disclosure documents);
- an overly granular prescription; and
- a lack of clarity about what the disclosure is for, and how it is used, across different categories of products.

65. The Law Council submits that the concept of the PDS needs to be entirely reworked to incorporate the recently introduced Design and Distribution Obligations (**DDO**) regime in Part 7.8A of the Corporations Act and substantial changes in technology and consumer behaviour in the 20 years since it was adopted. This, and other themes, are explored in the section below.

General observations regarding disclosure

66. The Law Council considers that a common set of disclosure rules across all products issued or sold to consumers is a desirable outcome. In response to the ALRC's specific request for views in the Interim Report,[11] the Law Council considers that it is both desirable and feasible to rationalise some, if not all, aspects of the disclosure regimes in Parts 6D.2 and 7.9 of the Corporations Act. To achieve this, among other measures, there needs to be harmonisation between different kinds of clients under Chapters 6D and 7 (namely, the disparate concepts of 'sophisticated investors', 'professional investors', 'wholesale clients' and 'retail clients') and also categorisation of 'securities' as only one kind of financial product.

67. The Law Council would prefer there to be one type of disclosure document as far as this is practicable, rather than the current myriad types of disclosure documents (i.e. prospectuses, short-form prospectuses, profile statements, offer information statements, 'long-form' PDSs, shorter PDSs and short-form PDSs).

68. Two main types of PDSs particularly stand out as needing reform. A PDS for a simple managed investment scheme is limited to eight pages and crammed with so much prescribed language that there is very little room for the product issuer to explain the risks, benefits and features of the specific product, with particularised

[10] For example, a listed stapled investment must be offered under a document that is both a Product Disclosure Statement and a prospectus, and this duplication serves no regulatory purpose.
[11] Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (November 2021) [9.140].

information often being incorporated by reference to another document. At the other extreme, a PDS for the initial public offering of a listed trust will comprise more than 100 pages and include a vast amount of complex information that the issuer includes for fear of not meeting disclosure standards. While the PDS for the listed trust might serve several purposes – including informing the market about certain information – what these PDSs have in common is that the retail clients they are intended to protect are unlikely to read (or understand) them.

69. The Law Council recommends that policy makers reassess the inherent value of disclosure, bearing in mind that ASIC itself has 'called time' on its effectiveness, stating that disclosure alone is often not sufficient to drive good consumer outcomes.[12] Notably, there has been a shift from a 'consumer-reads-and-decides' disclosure model to an 'issuer-as-gatekeeper' model under the DDO regime in Part 7.8A of the Corporations Act. Consumer behaviours should also be considered in this analysis. The Law Council submits that disclosure rules should facilitate, and perhaps assume, that disclosures will primarily be given in an electronic or digital form.

70. The Law Council recommends that policy makers should reconsider the complex disclosure requirements set out in the ASIC Corporations (Disclosure of Fees and Costs) Instrument 2019/1070 (**ASIC Fees Instrument**) and Regulatory Guide 97 *Disclosing fees and costs in PDSs and periodic statements* (**Regulatory Guide 97**). While the fees and costs disclosure under the ASIC Fees Instrument is an improvement to the disclosure regime set out in ASIC Class Order [CO 14/1252], overall there has not been a fundamental shift away from the form and style of the outdated and clunky disclosure model set out in Schedule 10 of the Corporations Regulations.

71. The 'if not, why not' disclosure principles and benchmarks set out in various ASIC regulatory guides have no force of law but require compliance, and demonstrate, in ASIC's view, that certain complex products require additional specific disclosures.[13] The Law Council does not object to a tailored disclosure regime for products of different levels of complexity, but considers that the prescribed content requirements should have force of law to ensure sufficient certainty. The requirements should also not derogate from the overriding principle of adopting an outcomes-based approach to disclosure regulation.

72. The Law Council submits that the disclosure regime, like the rest of the financial services regime, should be flexible enough to permit exceptions and exclusions. This is because a principles-based approach, along with the commercial reality of the differences between products, will inevitably lead to tailored rules for different products or different circumstances in which products are issued or sold. Rather than being concerned about exceptions to rules, the key principles should be where such exceptions should be found (e.g. legislative instruments or ASIC rules), and who should make such exceptions (e.g. Parliament, Treasury or ASIC).

Exclusions, exemptions and notional amendments

Proposal A9

73. The Law Council does not support this proposal. The dynamic nature of the financial sector, combined with the deliberately overinclusive and untailored nature of

[12] Australian Investments and Securities Commission, *Disclosure: Why it shouldn't be the default* (October 2019) <https://download.asic.gov.au/media/5303322/rep632-published-14-october-2019.pdf> 4.
[13] See, for example, ASIC Regulatory Guides numbered 45, 46, 69, 231, 232 and 240.

Chapter 7 of the Corporations Act, means the entire regime would be unworkable without the ability for an entity to make timely and sensible case-by-case or class adjustments where needed.

74. The Law Council notes the difference between class orders and case-by-case relief. There is no need for the latter to be consolidated into the legislation, but it should be published, such as on the ASIC website.

A9(a)

75. The Law Council does not support this proposal and submits that it is essential for ASIC to have the power to grant exemptions upon individual application where the law has unintended consequences.

76. Exemptions and modifications to allow legitimate business activity that would otherwise be prevented by laws with inappropriate or unintended consequences, are part of the daily operation of the financial services sector. The exemptions are published in the Government Gazette, which can be consulted as precedent for future applications, allowing for the monitoring of the consistency of exercise of ASIC's powers. Historically, ASIC has also produced reports of its significant decisions on relief applications, and the Law Council's practitioner members find this to be a useful resource.

77. In the Royal Commission's Final Report, Commissioner Hayne expressed a concern regarding the number of exemptions from financial services law.[14] However, in the experience of the Law Council's practitioner members, individual relief instruments are generally necessary and appropriate modifications of laws which would otherwise have an unintended application. The ALRC notes in its Interim Report that exemptions can be a 'hook' for ASIC to impose an alternative tailored set of obligations and prohibitions, but this is generally acceptable where the financial service provider has sought the individual relief and had the opportunity to review the conditions before asking ASIC to issue the instrument.[15]

A9(b)

78. The Law Council suggests that ideally, modifications to the text of sanctions of the Corporations Act should not be made through delegated legislation. Rather, Parliament should enact legislation to make amendments within the Act itself.

79. The Law Council is aware of concerns regarding new obligations that ASIC has created through legislative instruments. Specifically, ASIC's powers to impose obligations – directly or as a condition of a legislative instrument of broad application – have been of concern to the legal profession for some time. There is a sense among the legal profession that ASIC has used the AFSL regime as a 'trojan horse' to create tailored legislative regimes,[16] with the exercise of such powers by ASIC potentially contributing to growing legislative complexity. It is also arguable that such

[14] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report Volume 1* (4 February 2019) <https://www.royalcommission.gov.au/system/files/2020-09/fsrc-volume-1-final-report.pdf>.
[15] Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (November 2021) [10.56].
[16] Examples of law-making by ASIC include the class orders governing custody of assets, financial requirements for licensees, investor directed portfolio services operators, managed discretionary accounts and ASIC's expansive interpretation of the concept of making adequate provision for the consideration to acquire an interest in a managed investment scheme, all of which have resulted in the imposition of prescriptive requirements. Since the introduction of the 'fit and proper' test for licensees, ASIC has required substantially more paperwork and slowed the licensing process.

powers cut across the separation of powers and the rule of law, for reasons explained below.

Separation of powers

80. The Law Council is concerned that ASIC's existing power – to make legislative instruments that 'notionally' amend provisions of the Corporations Act and insert new obligations – could amount to the Executive overriding an Act of Parliament, which offends the fundamental principle that the Executive, Legislative and Judicial branches of government should be separate.

81. Australia is an outlier regarding the extent of ASIC's existing ability to modify the primary legislation. In his 2011 paper, Australian National University Professor Stephen Bottomley observed that:

> *This power is unique amongst Australian Federal regulatory agencies. It is also, as far as I can determine, unique amongst corporate regulatory agencies elsewhere.*[17]

82. Professor Bottomley points to the importance of predictability in rules relating to financial services, and notes that the significant number of class orders issued by ASIC shows that they are a regular part of ASIC's business of modifying the Corporations Act itself, not just making rules under it. He provides the example of ASIC using its powers to ban short selling in September 2008 in response to the global financial crisis, in which multiple class orders were issued in short succession:

> *In a period of just over four days, two new sections of the Corporations Act had come into operation, regulating a major form of market activity, and those sections had then been subject to several amendments, all without any parliamentary involvement.*[18]

Rule of law

83. As the ALRC has noted, the extent to which the Corporations Act is amended by regulations and instruments, which are difficult to both locate and interpret, raises rule of law concerns.[19]

84. The Law Council submits that a fundamental basis for economic activity and a just society is that a person should be able to determine, before they undertake an activity, whether that activity is lawful or not. In turn, this certainty promotes confidence to invest resources and to innovate. Indeed, predictability and certainty in the law are undermined when a statutory body – that is not directly accountable to the people – can override laws made by the Parliament.[20]

85. Should modification of the Corporations Act through delegated legislation continue to be permitted, the Law Council recommends that, where the law is not modified by Parliament, there should be a temporal limitation placed upon the operation of the relevant legislative instrument. This limitation would allow sufficient time for

[17] Stephen Bottomley, '*The Notional Legislator: The Australian Securities and Investments Commission's Role as a Law-Maker* (2011) 39 Federal Law Review 1, 2.
[18] Ibid 4.
[19] Australian Law Reform Commission, *Report A: Summary: Financial Services Legislation* (November 2021) [23].
[20] This important principle has been eroded by the product intervention power granted to ASIC under Part 7.8A of the Corporations Act, which allows products to be banned after launch even if there is no actual or suspected breach of any law. Any further erosion of the rule of law should be resisted.

Parliament to consider whether to enact appropriate legislation which will make the modification apply on an ongoing basis. If Parliament does not enact the corresponding modification within the specified time, the modification should lapse.

Costs considerations

86. The Law Council recognises that when new rules are introduced, irrespective of the process adopted to make the rules, significant costs are incurred by the financial services industry to ensure compliance with the new rules. While rules are subsequently amended or revoked altogether, the compliance costs incurred prior to that can never be reversed.

Proposal A10

87. The Law Council strongly supports the idea of rules – in the form of a thematically consolidated legislative instrument – combining all financial services-related regulations and other modifications, provided that the power to make and amend the rules is not solely vested in ASIC. It is important that secondary legislation can be located, so consolidating it in one place would certainly help.

88. It is the Law Council's view that ASIC should retain its power to grant case-by-case exemptions upon individual application, and a separate power should be granted to an appropriate body to make the 'rules' that impose obligations. The Law Council queries whether this issue could be more effectively resolved through the Legislation Act, which is currently being reviewed.

Framework

89. The Law Council agrees that a general modification power to create and modify a thematically consolidated book of rules is a very sensible proposal. This will not only reduce complexity and increase accessibility of the law, but it would be more efficient than the current approach, where various powers are limited to specific chapters, parts, divisions or sections which are unintuitively scattered through the Corporations Act.

90. One important aspect to consider is that financial services firms are governed by other parts of the Corporations Act in addition to Chapter 7. For instance, the operator of a listed managed investment scheme will be licensed under Chapter 7, but subject to:

- laws regarding meetings in Part 2G.4;
- financial reporting obligations under Chapter 2M;
- establishment and operation rules under Chapter 5C; and
- the takeover provisions in Chapter 6.

91. Accordingly, the Law Council considers it may be best to envision the financial services rules as one chapter (or several chapters) of what would eventually be a larger book of rules for the Corporations Act in its entirety.

92. The Law Council submits that the framework for the rule book should clarify that the rules must be subordinate to, and not permitted to go beyond, the intended scope of the primary law in the Corporations Act. In particular, the power to make rules should be separate from ASIC's power to grant case-by-case exemptions upon individual applications. If ASIC receives numerous requests for the same type of relief on the same fact pattern, it should be able to request that a rule be made to give the exception broad application.

Role of ASIC

93. The Law Council does not support the sole power to make the rules being granted to ASIC for several reasons. Firstly, ASIC's role should be in administration and enforcement of the law and providing guidance and facilitating activities where the law has unintended consequences. Its role should not be law-making. The ALRC's Interim Report refers to a recent statement by the Federal Treasurer that ASIC's role, as a regulator, is to deliver on Parliament's intent and not to supplement, circumvent or frustrate it.[21]

94. Secondly, ASIC's existing powers already reach beyond international norms and conflict with fundamental principles of the separation of powers and the rule of law.[22] The Law Council submits that to further extend these powers would exacerbate the situation. Specifically, it would be concerning if ASIC was a quasi-legislator but had limited effective accountability for such function.

95. Thirdly, the Law Council queries whether an agency responsible for surveillance and enforcement will have the willingness to accommodate the range of ideas needed for good policy development. Policy development should involve open and consultative consideration of what rules will provide the most appropriate balance between business efficiency and consumer protection. However, the Law Council is aware of a perception that significant changes rarely arise from ASIC's consultation processes when creating new policy. The Law Council would be interested to see data as to whether this perception within the legal profession can be substantiated.

96. The Law Council refers to two specific examples of ASIC adhering to its original policy proposals in the face of significant opposing submissions by industry, which resulted in a significant waste of resources and were ultimately wound back, namely:

- Regulatory Guide 97 and its associated legislative instrument, where an independent expert was engaged to improve the rules, which remain excessively complex and difficult to interpret; and
- ASIC's proposals to remove longstanding licensing exemptions for foreign financial services providers servicing wholesale clients in Australia, which the Government quashed as they were deemed harmful to international trade.

97. The Law Council accordingly submits that proportionality between protection for consumers and markets and the burden of prescriptive regulation may be better achieved with broader input to the policy underlying the rulemaking.[23]

98. Finally, the Law Council observes that industry participants tend to interpret ASIC Regulatory Guides as black-letter law. In this respect, a clear separation of rulemaking from guidance would mean that guidance has its proper place in the legislative hierarchy and is not afforded disproportionate prominence. This is important because ASIC's interpretation of the law, which is published in Regulatory Guides, will often not have been tested in the courts. Indeed, ASIC's appeal against Westpac relating to responsible lending laws failed in 2020 because the Full Federal Court disagreed with ASIC's interpretation of the law.[24]

[21] Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (November 2021) [10.29].
[22] See discussion above at Proposal A9.
[23] See discussion below at Proposal A11(b).
[24] *Australian Securities and Investments Commission v Westpac Banking Corporations* [2020] FCAFC 111.

99. The Law Council acknowledges that there are recent developments afoot which may help to make ASIC a nimbler and more focused regulator, including the establishment of the Financial Regulator Assessment Authority (**FRAA**) and the establishment by the new ASIC Chair of ASIC's own Regulator Efficiency Unit. However, the FRAA is tasked with oversight of ASIC's effectiveness and capability as a regulator (and not as to its law-making functions), and ASIC's own efficiency initiatives are not permanent. It is the Law Council's view that a body to make and amend the corporations rule book, which includes members outside to ASIC personnel, is preferable as it would provide an appropriate enduring structure and combination of expertise.

Question A11

A11(a)

100. The Law Council supports the recommendation for a hierarchy of laws that includes a simplified Corporations Act and a thematically consolidated set of legislative instruments, including all existing regulations and class orders. The Law Council understands this may be referred to as 'Implementation Orders', however, it is referred to in this submission as a 'rule book' for simplicity.

101. The Law Council believes that consolidation would deliver many significant benefits. Perhaps most importantly, the law will be more accessible and better understood, so that it may be more readily complied with. In addition, the current review and sunset process every 10 years under the Legislation Act results in the same ASIC instruments being remade with a new instrument number, which often makes them even harder to find. This would no longer be a problem with a consolidated rule book. However, the Law Council notes that the process under the Legislation Act would need to be adapted so that only the most recent changes can be disallowed by Parliament, not the entire rule book.[25]

102. The Law Council submits that the rule amendment process should be as agile as possible in order to keep pace with market developments. In this respect, the Law Council notes that clause 507 of the Corporations Agreement 2002 sets out broad exemptions to the requirement for state and territory approval for instruments made under Chapter 7 and other relevant chapters of the Corporations Act.[26]

103. The Law Council considers it to be helpful that prototype section 1098 at Appendix E of the Interim Report:

- limits penalties that may apply under the rule book to 500 penalty units;
- affords ASIC some limited emergency powers; and
- sets out matters to be considered in the exercise of such powers.[27]

This last point is particularly important, given the interpretation the High Court of Australia has placed on the existing scope of the delegated legislative power to be a 'wide discretionary power'.[28]

104. The Law Council considers that the matters to be considered in prototype subsection 1098(3) could be further bolstered by including the core principles, or norms of conduct (identified in the Royal Commission's Final Report) as a preamble

[25] Parliament has 15 sitting days during which it can revoke a legislative instrument that has been tabled.
[26] Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (November 2021) [5.145].
[27] Ibid Appendix E [prototype s 1098].
[28] *ASIC v DB Management Pty Ltd* (2000) 199 CLR 321.

to the rule book.[29] The Law Council considers all six principles would be appropriate, although queries whether 'obey the law' would be necessary, being external to the law itself.

105. The Law Council notes that Commissioner Hayne recommended that the law should be simplified so its intent is met and that the norms of behaviour which the laws seek to encourage should be identified.[30] The compilation of a rule book should take these recommendations into account and avoid prescribing numerous detailed and onerous obligations to provide reports, seek approvals and so forth. Obligations of this type do not go to the heart of providing financial services with integrity and commitment to service.

A11(b)

106. The Law Council is of the view that ASIC should not possess the sole power to make delegated legislation governing financial services.[31] Nonetheless, ASIC can make an invaluable contribution to the rule development process due to its direct experience of what can go wrong in the financial services industry and its roles in administration and enforcement, including processing relief applications.

107. The Law Council recommends the establishment of a new body, the Corporations Rules Committee (**CRC**), in order to promulgate the content of the rule book.

108. There are various models which can be drawn on to devise the structure and function of the proposed CRC. A useful example of an appropriate division of responsibility in law-making and administration is in the area of taxation. While Treasury has primary responsibility for advising on tax policy, the Australian Taxation Office (**ATO**) is a separate statutory authority responsible for administration of tax laws and revenue collection. Importantly, the ATO can have input on policy, but does not ultimately determine it.

109. The Law Council notes that the Corporations and Markets Advisory Committee existed from 1989 to 2018 and undertook important policy work. Its membership comprised an ASIC commissioner (nominated by the ASIC Chair) and four others, who were experts selected in consultation between the Commonwealth and the States. This model provides an example of the value-adding involvement of independent experts in the proposed CRC.

110. As a starting point, the Law Council suggests that the CRC be comprised of two members from ASIC, two from Treasury and a Chair who is an independent expert, perhaps reporting to the Senate's Economics Legislation Committee. Of course, the CRC would need adequate funding, dedicated senior personnel, and a secretariat function. However, as ASIC would have a lighter policy workload, a portion of its funding (and potentially some of its personnel with relevant expertise) could be allocated to the CRC.

111. The Law Council acknowledges that the question may be asked why yet another regulatory body is needed, this time in the form of the CRC. The answer is that the Corporations Act rule book will represent a core method of governance for the financial services industry and Australian business law generally (if all Chapters are

[29] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Final Report Volume 1 (4 February 2019) <https://www.royalcommission.gov.au/system/files/2020-09/fsrc-volume-1-final-report.pdf> [1.5.1].
[30] Ibid [4.1].
[31] See response to Proposal A10.

covered). The creation and administration of the rule book should have the funding, focus and expertise that such a significant role deserves.

Proposal A12

112. The Law Council supports this proposal as it would provide immediate benefits to providers and advisers in the financial services community, as well as other users of the legislation. The Law Council submits that a consolidated and hyperlinked electronic set of definitive financial services laws, provided by Government and available free-of-charge, would greatly improve accessibility of the law, reduce compliance costs and improve business efficiency. It would also promote 'equal access' to the law.

113. One way to achieve this outcome could be to create a master index of every Corporations Act section number, which tracks whether the section number is inserted by the Corporations Act itself, the Corporations Regulations or an ASIC legislative instrument, and whether it is modified or impacted by other provisions.

114. A master index of this type, provided that it is proactively maintained and updated, would improve the user experience and reduce the risk of unintentional duplication of section numbers by the Office of Parliamentary Counsel and ASIC. It would also be useful for identifying opportunities to consolidate provisions in delegated legislation into the Corporations Act for simplification purposes.

115. An example of the master index, using section 761G of the Corporations Act, is provided at **Appendix A** for illustration.

Definition of 'financial product advice'

116. The Law Council's comments in relation to Proposals A13, A14 and A15 are subject to the outcomes of the Quality of Advice Review currently being undertaken by Treasury.

Proposals A13, A14 and A15

117. The Law Council submits that there is a broader problem here which necessitates the removal of the concept of general advice and the recasting of the concept of financial advice.

118. The Law Council submits that there is no such thing as 'general advice' – it is an oxymoron. Something is either advice or it is not. If it is not advice (i.e. an advertisement or a sales call), then the general prohibitions on misleading or deceptive conduct should apply and should it be policed by a properly resourced consumer protection agency.

119. The Law Council recognises that there is a clear case for regulating people who provide financial advice on a commercial basis. The Law Council is of the view that such people should be licensed and properly supervised, and they should only be licensed if they can demonstrate they are competent and not conflicted in the provision of that advice. Having said that, there is also a role for product issuers to offer advice to their existing customers concerning their own product, for which it would be appropriate that different rules apply. For superannuation funds, this advice is currently provided and known as 'intra-fund advice', where no separate charge applies. The Law Council considers it is important that this type of limited, yet affordable, advice can continue to be offered. Various kinds of robo-advice also need to be considered in this context.

120. The Law Council observes that it is hard to define what makes something 'financial advice'. A starting point could be narrowing the existing definition of personal advice and limiting it to situations where there is a two-way exchange between the giver and the receiver (in person or via technology).

121. The exchange must then include the giver soliciting and obtaining information about the receiver's individual circumstances, and the giver providing a recommendation to acquire, retain or dispose of a particular financial product.

122. The circumstances must be such that a reasonable observer would think the giver has taken into account the information provided by the receiver in formulating the recommendation, and expected or intended that the receiver would change their position based on the recommendation.

123. The assumption is that if the giver is paid for the recommendation, there is an intention it be acted on. This might help resolve practical difficulties resulting from the expansive interpretation given by the High Court of Australia to 'personal advice' in *Westpac Securities Administration Ltd v Australian Securities and Investments Commission,*[32] where a telephone sales campaign was found to have involved the provision of personal advice.

124. The Law Council notes that lawyers will recognise that this type of exchange is likely to give rise to a fiduciary relationship between the giver and the receiver, even if it is a one-off interaction. This is why the 'best interest' duty makes sense in this context.

125. With regards to Proposal A14, the Law Council does not see the utility in regulating 'general advice' as the provision of a financial service. It is a business communication (and often a marketing one) like any other and should be addressed under the consumer laws, including in terms of appropriate disclaimers. Regulating it as a financial service creates an expectation that an agency, such as ASIC, is overseeing it for quality.

Definitions of 'retail client' and 'wholesale client'

126. As an introductory comment, the Law Council considers Questions A16 and A17 to be in the nature of policy changes. If these laws are to be amended, then the Law Council expects the law reform consultation process to be run in an appropriate manner for a legislative change which represents new policy (rather than one which is part of Bill containing refinements and 'miscellaneous amendments').

Question A16

127. The Law Council does not support abandoning the net assets and gross income tests for the reasons set out below. The Law Council's preference would be to instead make appropriate refinements to these tests.

128. The Law Council does not have a view regarding the product value test. Regardless, some observations have been set out below.

129. Some practitioner members of the Law Council have recommended the removal of the concept of 'retail client' altogether (due to the unhelpful message it sends to the public by appearing to be 'sophisticated') and replacing it with the more accessible concept of 'financial consumer'.

[32] [2021] HCA 3.

Recognition of wholesale client protections

130. While retail clients have more protection than wholesale clients, it is also important to bear in mind that some protections apply to both retail and wholesale clients.

131. The Law Council notes that AFSL holders must provide financial services to all clients efficiently, honestly and fairly and have appropriate arrangements in place to manage conflicts of interest. Engaging in misleading and deceptive or dishonest conduct is prohibited, irrespective of whether an investor is a retail or wholesale client.

International comparability

132. The Law Council notes that other jurisdictions, such as the United Kingdom, the United States, Singapore, Hong Kong and New Zealand also have assets and/or income tests which, if met, allow for the relaxation of some investor protections. This has recently been observed in a discussion paper released by the Stockbrokers and Financial Advisers Association.[33]

133. The Law Council considers that retaining the existing net assets and gross income tests would therefore be more consistent with comparable international jurisdictions.

Indexation for product value, gross income and net assets thresholds

134. The Law Council acknowledges that the proportion of the Australian population who meet the 'wholesale client' definition has increased significantly as a result of there being no indexation of the product value, net assets and gross income tests (for the past two financial years). If these tests are to be retained, the Law Council submits that indexation could be used to prevent unintentional 'wholesale creep'.

135. The Law Council recognises that indexation of the dollar amounts could introduce complexity and uncertainty if adjustments were frequently made to align with changes in the Consumer Price Index (**CPI**). There could also be frequent inadvertent non-compliance. For instance, if accountant's certificate templates are not updated to reflect the new threshold amounts (due to insufficient attention to detail or awareness of regulatory change – which is not infrequently a cause of breaches), the potential exists for an investor to be above the previous threshold but below the new adjusted threshold. If an outdated template is used, then an investor might be incorrectly characterised as wholesale and not given the intended regulatory protection.

136. For simplicity, if indexation was adopted, the Law Council suggests that:

- the product value threshold be increased in $100,000 increments (e.g. where the threshold starts at $500,000, and once CPI has increased by 20%, the threshold moves to $600,000);
- the gross income threshold be increased in $50,000 increments (e.g. where the threshold starts at $250,000, and once CPI has increased by 20%, the threshold moves to $300,000); and
- the net assets threshold be increased in $500,000 increments (e.g. where the threshold starts at $2.5 million, and once CPI has increased by 20%, the threshold would move to $3 million).

[33] Stockbrokers and Financial Advisers Association, *Does the wholesale investor test need to change?* (February 2022) <https://www.stockbrokers.org.au/wp-content/uploads/FINAL_SAFAA-DiscussionPaper-WholesaleInvestorTest-280122.pdf> 14.

137. For ease of implementation and to limit any compliance burdens (e.g. to allow time for the accountant's certificate templates to be updated), the Law Council recommends that any changes to thresholds be introduced:

- on not less than six months' notice; and
- to take effect at the beginning of a financial year (1 July).

138. The Law Council notes that there have been recommendations made that an individual's primary place of residence ought to be excluded from the net assets test. Indeed, there is a class of investors who have wholly or partly crossed over the 'wholesale client' threshold because of increases in the value of their primary place of residence. However, the concern with this recommendation is that it complicates the process for assessing whether an individual is a wholesale client.

139. The Law Council envisages that an investor may qualify as a 'wholesale client' at a certain point in time because they have sold their primary place of residence and are yet to purchase another. During the time when they do not own a primary place of residence, they might have net assets (not including a primary residence) of at least $2.5 million, and in that period, they could obtain an accountant's certificate that would afford them wholesale client status for two years. It would also be burdensome to require the accountant responsible for issuing the certificate to undertake detailed due diligence on an individual's investment history to verify their source of wealth (i.e. the proportion of wealth attributable to a recent sale of a primary residence).

140. The Law Council's view is that indexation of the thresholds would be a more efficient way to prevent unintentional 'wholesale creep'.

Product value test

141. The Law Council submits that an alternative to entirely abolishing the product value test ($500,000) threshold would be to remove it for particular products which are considered to be higher risk. This has already been done in relation to foreign exchange contracts in regulation 7.1.22A of the Corporations Regulations.

142. The Law Council is also aware that some product issuers prefer not to characterise investors as wholesale based solely on the amount invested. This is because it could be considered 'risky' when the product issuer does not know anything about the investor's circumstances.

Gross income / net assets test

143. The Law Council submits that if this test was to be abolished, some investors who are currently treated as 'wholesale' could be potentially financially worse off because the range of financial products they could access would shrink. Further, the remaining available products to these investors would likely involve greater fees, due to higher compliance costs of servicing retail investors. Several wholesale product issuers could also lose a segment of their investor base if this was to occur.

144. If there is to be a significant one-off increase in, for example, the net assets threshold (e.g. to account for the CPI increase in the past 20 years), the Law Council would recommend that the $2.5 million net assets test be grandfathered. This is so that individuals who met the net assets test on or before the date the law changed could continue to be treated as wholesale clients for the remaining duration of their existing accountant's certificate. This would also enable a transition period for the introduction of the new test of 24 months, as has been used for previous

legislative reforms impacting the financial service industry. This would minimise the negative impact and potential disruption for affected product issuers.

145. If this test is retained, the Law Council strongly recommends that the modifications to the Corporations Act made by regulations 7.6.02AG and 6D.2.03 make it clear in the primary legislation that the accountant's certificate needs to be renewed every two years rather than every six months.

Alternatives to abolishing product value, gross income and net assets tests

146. The Law Council suggests that instead of removing the product value, gross income and net assets tests (where a product is available to investors who meet any of these tests), a new obligation could be introduced requiring the offer document material provided to these investors to contain a warning to the effect that:

- the document is not a PDS (assuming PDS or similar disclosure remains);
- the product is only offered to wholesale clients; and
- wholesale clients receive less regulatory protection than retail clients.

147. An alternative option would be to expand the scope of the product DDO regime in Part 7.8A of the Corporations Act so that the regime applies to particular products that are assessed as high risk and which are offered to investors qualifying as wholesale under any of the value, gross income and net assets tests. For example, if a target market determination had been prepared for the Mayfair 101 products, the Law Council considers that this would have reduced the number of people who made an investment that involved an inappropriate level of risk.

148. Further, in the context of superannuation funds, the Law Council suggests, at a minimum, that section 761G of the Corporations Act be amended so as to clearly conform to ASIC's no-action position. This position, announced in August 2014, states that ASIC will take no action where a self-managed superannuation fund (**SMSF**) trustee is treated as a wholesale client, notwithstanding that the trustee does not meet the $10 million net asset threshold, even though the financial service in question may relate to a superannuation product (see paragraph 761G(6)(b)).

149. The provision in question, paragraph 761G(6)(b), is uncertain – specifically, the concept of a service 'relating' (or not) to a superannuation product. In 2004, ASIC stated in QFS 150 that a financial service would generally relate to a superannuation product where it was provided to an SMSF trustee. Therefore, in line with ASIC's 2004 view, an SMSF trustee needed to have net assets of at least $10 million in order to be qualified as wholesale. In August 2014, ASIC 'reversed' its earlier view, and published the no-action position referred to above.

150. While ASIC's no-action position was welcome at the time, it is unsatisfactory that industry participants still need to choose whether to rely on that position almost eight years later, when it may not actually reflect the law. This is particularly so given that, as ASIC itself noted, the no-action position does 'not affect any private rights of action that may be available to third parties'. This Inquiry provides an opportunity to make the law on this topic clear, and the Law Council submits that the ALRC should make a recommendation accordingly.

Question A17

151. The Law Council does not wish to express a particular view on section 761GA, but notes that the term 'sophisticated investor' has been used in Chapter 6D of the Corporations Act to describe an investor who is able to provide an accountant's

certificate to confirm they meet the net assets or gross income test equivalent to the tests which apply in Chapter 7 under section 761G.

152. The Law Council submits that it is confusing to use 'sophisticated investor' in connection with section 761GA when it has an entirely different meaning. The Law Council would accordingly encourage the removal of this inconsistency by renaming the test in one of these provisions.

Conduct obligations

Questions A18 and A19

153. There is an underlying assumption in these questions – that Chapter 7 itself is coherent in its current form – with which the Law Council fundamentally disagrees.

154. It should be queried whether restating norms is necessary to help regulated entities or courts interpret their substantive obligations. Regardless, the Law Council supports the six norms identified in the Royal Commission's Final Report, as set out in Interim Report A.[34]

Proposal A20

155. The Law Council observes that part of the problem is that paragraph 912A(1)(a) of the Corporations Act was intended as a licensing criterion, not a legal duty. It is about who is fit to be licensed to provide financial services, and how they must operate their financial services business overall to remain entitled to operate in this space. That is why it is supposed to be an omnibus standard, rather than a legal duty in relation to a particular dealing with an individual counterparty.

156. Behaving dishonestly in the provision of financial services is an offence and the Law Council notes that 'efficiently' is not the same as 'professionally'. These are different relationships with different duties, as a professional has an overarching duty that prevails over their duty to their individual customer.

157. On the 'fairly' definition, the Law Council reiterates its comments about defining open-textured standards.[35] The Law Council is aware of a sense that 'examples' like these in legislation or ASIC Regulatory Guides often tend to be unhelpful and may serve to undermine the hortatory effect of the standard. In addition, the note as suggested at (c) should also be informed by the findings of the Australian Financial Complaints Authority's Fairness Project. In any reformulation of the 'fairly' definition or obligations pursuant to paragraph 912A(1)(a), the ALRC should also pay regard to the 'fairness covenants' that apply to all superannuation fund trustees, pursuant to paragraphs 52(2)(e) and (f) of the SIS Act, and the potential for duplication of regulation of these matters.

Proposal A21

158. The Law Council does not support this proposal. The core function of subsection 912A(1) is to set out what a person must do, and have, to be entitled to obtain and retain an AFSL. These provisions make it clear – for ASIC and the regulated entity – what those criteria are. The Law Council suggests that it is helpful to think of these as quasi-prudential standards, rather than rules of conduct.

---

[34] Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (November 2021) [13.36].
[35] See response to Question A2 above.

159. The Law Council considers that the removal of these prescriptive requirements may lead to downplaying the ongoing importance of these specific aspects of the licensing regime. The Law Council also notes the Interim Report expresses similar concerns.[36]

160. If the ALRC ultimately recommends the removal of these requirements, then the Law Council suggests that their subject matter still be noted as examples of how AFSL holders can demonstrate they are meeting their licence and conduct obligations.

161. Further, in consideration of these matters, the Law Council notes superannuation fund trustees are already subject to similar prudential requirements pursuant to the statutory covenants under subsection 52(2) of the SIS Act and the APRA Prudential Standards. Again, any duplication or overlapping of regulation of such matters should be avoided.

Proposal A22

162. The Law Council supports this proposal and agrees with the reasoning in the Interim Report.[37]

Proposal A23

163. The Law Council supports this proposal and considers that there are several other parts of the ASIC Act which would benefit from relocation, along with all of Part 2 Division 2, such as Parts 3A and 3B.

Question A24

164. The Law Council supports this proposal and submits that subsection 961B(2) and sections 961C and 961D of the Corporations Act should be repealed.

165. Section 961B should be redrafted to match the approach adopted in sections 181 and 601FC of the Corporations Act regarding similar 'best interests' duties. It should state that an AFSL holder or representative, who provides financial advice to a financial consumer, must act in the best interests of that consumer.

166. For completeness, the Law Council also suggests that any review of 'best interests' obligations have regard to the statutory 'best financial interests' covenants (formerly 'best interests' covenants) that apply to superannuation trustees and their directors, pursuant to paragraphs 52(2)(c) and 52A(2)(c) of the SIS Act.

[36] Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (November 2021) [13.119].
[37] Ibid.

Appendix A – Example Master Index (Proposal A12)

Section no. (Corps Act)	Inserted by	Impacted / modified by
761G(1)	Corporations Act	
761G(2)	Corporations Act	
761G(3)	Corporations Act	
761G(4)	Corporations Act	
761G(4A)	Corporations Regulation 7.6.02AD	
761G(5)	Corporations Act	Further definitions provided in: • Corporations Regulation 7.1.11 (motor vehicle insurance product) • Corporations Regulation 7.1.12 (home building insurance product) • Corporations Regulation 7.1.13 (home contents insurance product) • Corporations Regulation 7.1.14 (sickness and accident insurance product) • Corporations Regulation 7.1.15 (consumer credit insurance product) • Corporations Regulation 7.1.16 (travel insurance product) • Corporations Regulation 7.1.17 (personal and domestic property insurance product) • Corporations Regulation 7.17A prescribes a medical indemnity insurance product
761G(6)	Corporations Act	
761G(6A)	Corporations Act	Corporations Regulation 7.1.17C (traditional trustee company services)
761G(7)	Corporations Act	• Corporations Regulation 7.1.18 (price of investment based financial product) • Corporations Regulation 7.1.19 (value of investment based financial product) • Corporations Regulation 7.1.19A (price of margin lending facilities) • Corporations Regulation 7.1.20 (price of income stream financial products) • Corporations Regulation 7.1.21 (value of income stream financial products) • Corporations Regulation 7.1.22 (value of derivatives)

		• Corporations Regulation 7.1.22AA (value of contracts for difference) • Corporations Regulations 7.1.22A (value of foreign exchange contracts) • Corporations Regulation 7.1.23 (price of non-cash payment products) • Corporations Regulation 7.1.24 (value of non-cash payment products) • Corporations Regulation 7.1.25 (Life risk insurance and other risk-based financial products) • Corporations Regulation 7.1.26 (Superannuation sourced money) • Corporations Regulation 7.1.28 (assets and income) • Modified by Corporations Regulations 7.6.02AF to remove '6 months' from paragraph (c) and replace it with '2 years' • Modified by Corporations Regulation 7.6.02AB to insert additional paragraph (ca)
761G(7A)	Corporations Regulation 7.6.02AC	
761G(7B)	Corporations Regulation 7.6.02AC	
761G(8)	Corporations Act	
761G(9)	Corporations Act	
761G(10)	Corporations Act	• Corporations Regulation 7.1.18 (price of investment based financial product) • Corporations Regulation 7.1.18 (price of investment based financial product) • Corporations Regulation 7.1.17B (aggregation of amounts for price or value) • Corporations Regulation 7.1.19A (price of margin lending facilities) • Corporations Regulation 7.1.22 (value of derivatives) • Corporations Regulations 7.1.22A (value of foreign exchange contracts) • Corporations Regulation 7.1.24 (value of non-cash payment products) • Corporations Regulation 7.1.27 (effect of wholesale status)
761G(10A)	Corporations Act	
761G(11)	Corporations Act	