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16 March 2022

Australian Law Reform Commission
119 North Quay
Brisbane QLD 4000

Dear Sir / Madam

Interim Report A - Financial Services Legislation
ALRC Report 137

Allens welcomes the opportunity to comment on the Australian Law Reform Commission's *Interim Report A on Financial Services Legislation* (ALRC Report 137), issued in November 2021.

Attached are our submissions on the following Proposals and Questions set out in the Interim Report:

Proposal	Questions
A4	Definitions of 'financial product' and 'financial service' and incidental product exclusion
A5	Definitions of 'makes a financial investment', 'manages a financial risk' and 'makes non-cash payments'
A6	Definitions relating to credit
A9	Powers to grant exemptions and to notionally amend
A10	Power to create exclusions and grant exemptions in a consolidated legislative instrument
A11	Power to make thematically consolidated legislative instruments in the form of 'rules'
A18 – A19	Insertion of certain norms as an objects clause
A20	Efficiently, honestly and fairly
A21	Removal of prescriptive requirements
A22	Repeal of section 991A Corporations Act and section 12CA ASIC Act
A23	Consolidation of provisions concerning false or misleading representations and misleading or deceptive conduct

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Allens is an independent partnership operating in alliance with Linklaters LLP.

We support this important review of the *Corporations Act*, which we hope will result in a clearer, simpler and more accessible legislative framework for the regulation of financial services. We believe that other financial services legislative regimes would also benefit from a similar review in due course, particularly the *Superannuation Industry (Supervision) Act 1993* (Cth).

Please let us know if you would like to discuss any aspect of our submissions.

Yours sincerely

Penny Nikoloudis
Partner
Allens

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'.

<u>Summary</u>

We support the proposals in paragraphs b., c., e., and f.. However, we do not support the proposals in paragraphs a. and d..

<u>Paragraph a. - remove specific inclusions from the definition of 'financial product'</u>

We worry that the ALRC's proposal in paragraph a. is based on concerns that are almost entirely theoretical. As practitioners who apply Chapter 7 of the Corporations Act in our daily work, we very much doubt there would be any practical advantage in removing the specific inclusions. And we worry there would be practical disadvantages in removing them.

The ALRC says that 'the use of specific inclusions creates significant complexity in applying the definition of financial product' (at [7.115]). However, it appears that this 'complexity' flows largely from the fact that many of the specific inclusions use 'further defined terms' (at [7.97]). Some of these definitions are complex, including because (in some cases) they 'use concepts from other Commonwealth Acts' (at [7.98]). And then there are terms that have different meanings in different parts of the Corporations Act – the term 'security' is given five different meanings across the Corporations Act (at [7.100]); while the definition of 'derivative' is said to be 'technically complex' and that 'complexity is exacerbated by the extent to which the definition, and inclusions or exclusions from it, are spread across various provisions of the Corporations Act and Corporations Regulations' (at [7.106]).

Even if all this is accepted, removing the specific inclusions would not, of itself, do anything to reduce complexity. As we read the Interim Report, the ALRC is not proposing that defined terms used in section 764A(1) (eg 'security': see section 764A(1)(a)), or terms that are defined by reference to section 764A(1) (eg 'superannuation product': see section 764A(1)(g)), cease to be defined or used. For example, section 995A(3) of the ALRC's prototype legislation provides (emphases added):

> This Part does *not* apply to a financial product unless:
>
> (a) it is or was issued, or will be issued, in the course of a business of issuing financial products; or

(b) paragraph (a) is not satisfied but the financial product is:

(i) a **managed investment product**; or

(ii) a **foreign passport fund product**; or

(iii) a **superannuation product**.

So, it appears that 'managed investment product' (see currently sections 761A and 764A(1)(b)), 'foreign passport fund product' (see currently sections 761A and 764A(1)(bb)) and 'superannuation product' (see currently sections 761A and 764A(1)(g)) are still proposed to be used (and presumably defined, at least to some extent) and to be recognised in the legislation as specific types of financial products. In that context, repealing section 764A would not, of itself, do anything, in substance, to reduce complexity. It would make next to no impact on the length of the legislation – even with annotations, the section runs to less than 2 pages (out of almost 3,000 pages of the *Corporations Legislation 2021* volume published by Thomson Reuters).

Against this, as practitioners we find section 764A useful. We accept that, often, it serves as merely the first step in a 'snakes and ladders' exercise of tracing through to other parts of the Corporations Act and/or to other Commonwealth legislation. However, it is useful in that that first step is conveniently located within the provisions that define the term 'financial product' (ie Division 3 of Part 7.1). If the definitions for some of the specific inclusions need work, in particular simplification, we would not disagree. However, there is nothing objectionable about the idea of having specific inclusions.

In our respectful opinion the debate about whether any of the specific inclusions do or do not fall outside the general definitions (at [7.117] – [7.120]) is ultimately a distraction. A key benefit of having specific inclusions is that you know it is a financial product without having to enter into that particular debate. The ALRC acknowledges that removing specific inclusions 'could reduce certainty'. In our view, it would reduce certainty and doing so would be unnecessary and undesirable. And in our respectful opinion the ALRC's proposed measures to combat the associated uncertainty are problematic.

First, the ALRC says that 'the range of examples in notes to the [general] definition[s] could be expanded' (at [7.122]). In our experience, including examples in notes to operative provisions is a very poor way of seeking to clarify the scope and operation of the provision. While notes in legislation are relevant to interpretating legislation, in our experience they very rarely assist. Invariably, they lack the precision that can be achieved through careful drafting. An excellent example is provided by regulation 7.6.01(1)(m) of the Corporations Regulations, which includes the following notes:

> Example of financial service to which paragraph (m) applies:
>
> A series of forward foreign exchange contracts entered into by a gold mining company to hedge against the risk of a fall in the price of gold.
>
> Example of financial service to which paragraph (m) does not apply:
>
> The issue and disposal of derivatives relating to the wholesale price of electricity are not transactions to which this paragraph applies.

All these examples do is pose the question, when applying regulation 7.6.01(1)(m), whether the situation under consideration is more like the first example or more like the second example. In our experience the answer to that question is very often quite unclear. And so the examples do not in fact provide certainty.

Secondly, the ALRC says that 'regulatory guidance could be used to clarify whether the regulator considers particular products to be regulated' (at [7.122]). In our experience, regulatory guidance can be a very poor indicator of the correct interpretation of legislation. Indeed, very often it is more productive of uncertainty than ameliorative of it. And regulatory guidance does not confer any relief from the consequences of a contravention if the guidance turns out to be wrong.

Thirdly, the ALRC says that 'the current functional definition could be amended to the extent necessary to capture current specific inclusions' (at [7.122]). This suggestion begs the question – why repeal section

764A in the first place? If the only response to that question is that most of the specific inclusions undoubtedly fall within the general definitions, we respectfully suggest that that would be a theoretical response to problem that does not in fact exist.

Paragraphs b. and c. - remove the ability for regulations to deem conduct to be a 'financial service'

As noted earlier, we support these proposals and it is unnecessary to say more about them.

Paragraph d. - remove the incidental product exclusion

The ALRC says:

> The incidental product exclusion in s 763E is an unnecessary source of complexity. The policy objective of excluding incidental products could better be achieved by specific exclusions or exemptions.

In our respectful opinion the difficulty with this statement is that unless and until a specific exclusion or exemption is made, something that is, by definition, only incidentally a financial product, will be regulated, indeed it will be regulated in the same way as a product that sits at the heart of one of the general definitions. The ALRC says that the incidental product exclusion 'significantly complicates the process of establishing whether something is a 'financial product'' (at [7.145]). In our respectful opinion that is an overstatement. The exclusion does introduce an additional step in the process, but it is only one step amongst others, and the cases where the additional step requires any real consideration are, in practice, very few and far between. But where the additional step requires any real consideration, we submit that if the arrangement is, on close inspection, only incidentally a financial product, it should be excluded from the regulatory regime.

Paragraph e. - insert application provisions

As noted earlier, we support this proposal and it is unnecessary to say more about it, other than to note that Chapter 7 already contains various 'application provisions' – see, for example, sections 1010A, 1010B, 1016A(1) (definition of 'relevant financial product'), 1017B(2), 1017C(1) and 1017D(1)(b).

Paragraph f. - consolidate, in delegated legislation, all exclusions and exemptions

As noted earlier, we support this proposal and it is unnecessary to say more about it.

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)).

<u>Summary</u>

We support the proposals in paragraphs a., b., and c, provided that key elements of the existing definitions are imported into the functional definition of 'financial product' or are preserved through exclusions.

In our view, it is unnecessary to include the definitions as an intermediary step where there is a functional definition of 'financial product' that is capable of bearing a meaning in accordance with its ordinary terms, and there are specific exclusions and inclusions. In respect of the examples proposed in the prototype legislation in Appendix E, we refer to our comments in proposal A4 on the limited assistance that examples provide.

<u>Paragraph a. – remove definition of 'makes a financial investment'</u>

We agree with the ALRC that the removal of the definition of 'makes a financial investment' would simplify the legislation. In this respect, we note the comments of Finkelstein J in *Australian Securities and Investments Commission v Money for Living (Aust) Pty Ltd (Administrators Appointed) (No 2)* (2006) 155 FCR 349 that the definition may in fact create complexity in construing a term that is capable of bearing a meaning in accordance with its ordinary terms (see [7.183] – [7.189].)

However, we consider that the following component of the existing definition should be preserved by incorporation into the relevant functional definition or otherwise by way of exclusion (see s 763B(b) of the Corporations Act and s 12BAA(4) of the ASIC Act):

> the investor has no day-to-day control over the use of the contribution to generate the return or benefit.

We consider this component to be an important aspect of the definition that is not otherwise apparent on the face of the wording 'makes a financial investment'. This aspect derives from this same element of the definition in 'managed investment scheme' in section 9 of the Corporations Act – absent that detail, it could capture an interest in a bare trust (which we think would not be intended).

Similarly, we also consider that the elements contained in section 763B and section 12BAA(4) of money or money's worth being given to another person for the purpose of generating a financial return provide greater certainty as to the types of arrangements that are intended to be captured (or not captured) and should therefore also be preserved by incorporation into the relevant functional definition or otherwise by way of exclusion.

<u>Paragraph b. – remove definition of 'manages financial risk'</u>

We agree that this term is capable of bearing a meaning in accordance with its ordinary terms. We do not consider it necessary to preserve any element of the existing definition in the legislation.

Paragraph c. – remove definition of 'makes non-cash payments'

We agree that this term is capable of bearing a meaning in accordance with its ordinary terms.

For clarity, we consider that the following component of the existing definition should be preserved by incorporation into the relevant functional definition or otherwise by way of exclusion:

> otherwise than by the physical delivery of Australian or foreign currency in the form of notes and/or coins

We agree with the ALRC that the exclusions contained in section 763D(2) of the Corporations Act can be accommodated as exclusions using an application provision rather than exclusions from the defined term.

Proposal A6:

In order to implement Proposal A6:

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

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

c. a definition of 'credit' that is consistent with the definition contained in the *National Consumer Credit Protection Act 2009* (Cth) (***NCCP Act***) should be inserted in the Corporations Act and in the ASIC Act.

Summary

We support the proposal in paragraph a, and the intention of the proposals in paragraphs b. and c. However, in respect of paragraphs b. and c., we respectfully suggest that the ALRC revisit particular aspects of the proposal for the reasons outlined below.

Discussion

1. The inconsistent definition of 'credit' across multiple Commonwealth laws unnecessarily complicates the interpretation of various obligations that apply to providers of credit. We therefore broadly support the proposal to introduce a general definition of credit that is not supplemented by specific inclusions to form part of the functional definition of 'financial product'.

2. However, the introduction of such general definition must be approached with care. As the ALRC notes, the Corporations Regulations and the ASIC Regulations include in the definition of credit various facilities that arguably do not fall within the general definition of 'credit'. However, these inclusions – particularly in the context of the ASIC Regulations – serve an important consumer protection purpose by ensuring consumers who enter into contracts for these financial products or receive financial services in relation to them have the benefit of those consumer protection provisions under Division 2 Part 2 of the ASIC Act, particularly those in subdivision BA relating to unfair contract terms. We note the ALRC has proposed three options to address this point, and we favour the option articulated at [7.210].

3. Given the patchwork approach that has been taken in recent years to amending the Corporations Act, particular care will be required to understand the 'downstream' effect of repealing reg 2B of the ASIC Regulations and introducing a general definition of 'credit'. For example, the design and distribution obligations (***DDO***) in Part 7.8A of the Corporations Act define a 'financial product' by reference to a 'financial product' within the meaning of Division 2 Part 2 of the ASIC Act. This has the

initial effect of applying the DDO regime to the facilities outlined in reg 2B of the ASIC Act, including to those that are not typically considered to be 'credit' – e.g. guarantees and leases – but these are then subsequently excluded by reg 7.8A.20 of the Corporations Regulations. While we support simplification attempts, it will be critical to ensure these downstream effects are identified and addressed so as to avoid disrupting the policy objective for the current obligations on financial services providers.

4 A broader question arises in relation to the scope of the definition of 'credit'. Although we support the proposed general definition that requires a deferral of debt or a deferral of a repayment obligation owed to a credit provider, there are questions to answer as to:

(a) whether there will be, or should be, limitations on who will be a 'credit provider' for these purposes (e.g. will this include providers of credit to small business). We note Commissioner Hayne was not in favour of altering the NCCP Act in order to govern lending to small and medium enterprises;

(b) whether the various provisions of the National Credit Code (***NCC***), which play a role in defining 'credit' under the NCCP Act, should be replicated as part of the general definition.

5 We note the ALRC proposes at [7.195] to adopt a definition of 'credit' based on reg 2B(3)(a) of the ASIC Act and s 3(1) of the NCC. In relation to s 3(1) of the NCC, we note that this does not represent the complete definition of credit to which the NCC applies. Section 3(1) is supplemented by s 5 of the NCC (which goes on to specify when the provision of credit is subject to the NCC) and s 6 of the NCC contains a list of specific exclusions from the definition of credit. The *National Consumer Credit Protection Regulations 2010* (Cth) (***NCCP Regulations***) also includes a substantial list of exemptions and modifications that exempt particular types of credit or providers of credit from all or parts of the NCC.[1] We respectfully submit that the ALRC consider these definitions and exemptions in their entirety, including the specific inclusions and exclusions provided by the NCC and the NCCP Regulations, in formulating the general definition of credit and as part of further consolidation discussions relating to the Corporations Act, the ASIC Act and the NCCP Act.

Proposal A9

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

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

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

Proposal A10

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

<u>Summary</u>

We broadly support these Proposals but believe that considerable further work is needed to develop a more coherent and developed structure for the proposed changes. Also, our support is subject to and given in the context of our comments on other Proposals.

[1] See chapter 7 of the NCCP Regulations

Proposals A9 and A10

These Proposals are really two sides of the one idea and should be understood accordingly. They must also be seen in the context of the Proposals that precede them (and our comments on them).

As the Interim Report itself acknowledges (at [10.8]), the implementation phase of these Proposals will involve a significant program of work. In our view, more work is required to settle on the proposed 'legislative architecture' itself.

It seems to us that Proposal A10, as expressed above, does not capture what is actually proposed and that what is proposed is itself elusive: the body of the Chapter explores or mentions several variations on the Proposal (sometimes in the same paragraph). To provide some examples:

- One 'sole power' to make exclusions and exemptions in 'a single consolidated legislative instrument'……a single power to make 'rules' in legislative instruments regarding specified matters (at [10.5]);
- 'Proposals A9 and A10 are designed to:
  - remove existing powers to notionally amend Chapter 7 of the *Corporations Act* by delegated legislation; and
  - facilitate the consolidation of exclusions and exemptions from obligations in Chapter 7 of the *Corporations Act* in a single place' (at [10.37]);
- Legislative instruments would be used to present rules relating to one theme, for example a rule for financial product disclosure and a rule for licensing (at [10.103-105]);
- 'The legislative framework is likely to be more navigable if exclusions and exemptions are arranged in a more appropriate structure. Part 7.9 of the *Corporations Act* could be reorganised such that key obligations remain in the Act, exclusions and exemptions are consolidated in a legislative instrument, and other detail is set out in a legislative instrument relating to disclosure' (at [10.126]);
- Based on the Prototype legislation in Appendix E, there will actually be a series of provisions (related, to, for example, what are financial products) which confer modification powers, the source and substance of which are set out elsewhere (Part 7.11A). In order to establish the scope of the modification powers, it is necessary to first assess the scope granted under the 'enabling' power and then the 'source' provisions (ie Part 7.11A). Then there will be series of thematic instruments, one or more of which may be relevant, depending on the fact scenario.

We appreciate that Interim Report B is intended to explore in more detail the appropriate model for the legislative hierarchy (at [10.133]). Upon conclusion of that work, the ALRC may be in a position to provide further clarity on the form Proposal A10 may ultimately take.

Proposal 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?

Summary

We broadly support the Act being amended to allow for the power to make 'rules'. We believe that ASIC should be granted various powers with varying constraints depending on the underlying reason for the power and its scope.

Paragraph a.

We generally support the approach of thematic instruments that set out relevant rules and therefore a power to allow this.

We do expect, however, that implementation will be challenging with a high probability, at least at the outset, of overlap or gaps between the various instruments. Despite this, we do not support the alternative suggested approach of 'super instruments' on topics as wide as 'Financial Services Rules' (10.72) would, we suspect, be unwieldly, difficult to navigate and just as likely to involve 'demarcation' issues (albeit wider ones).

We also respond to some sub-topics raised in relation to rules and rule-making powers.

- (**Notional amendment powers unnecessary**) We generally accept the proposition that if – or at least to the extent that – prescriptive detail is removed from the Corporations Act there should be less need for powers to notionally amend the Act (at [10.83]). To put it another way, any changes to the Act are more likely to be appropriately undertaken by amending legislation.

- (**A single rule maker**) We do not support the sole rule-making power being conferred on a Minister (even where the power is delegable) for the dual reasons of (i) potential slowness to respond to market developments and issues; and (ii) over-politicisation of the process (at [10.9]). We do not see any need for the rule-making power being limited to one person or institution. What is more important are practical and reasonably specific consultation processes in relation to any proposed rules or amendments to them. We explore this further in our discussion below on paragraph b. of Proposal A11.

- (**Rules as policy**) At paragraph [10.81] of the Interim Report there is a suggestion that 'some of what is currently guidance issued by ASIC should instead be expressed as binding rules'. We agree with this if it means that matters that should have legislative force are given it. However, we do not support rules that are drafted as guidelines or general matters of policy being elevated to binding rules because they inevitably lead to uncertainty and differing interpretations.

- (**Less legalistic drafting**) At paragraph 10.109 it is suggested that rules 'would potentially enable a less legalistic drafting style than is currently necessitated by exemption and notional amendment powers'. While this is a reasonable and worthwhile aspiration, we would not support drafting of rules that lacked precision because they were expressed informally or in a short-form way.

- (**Publish a compendium of all legislative instruments**) We also support the idea of an (on-line) compendium of exemptions and exclusions along with all legislative instruments in force (similar to the FCA Handbook) (at [10.108]). We would prefer that this be prepared by a government agency rather than a private publisher and ideally it would have 'publication of record' status so that it could be relied on by users. ASIC's current website is not easy to use and has an inadequate search function.

- (**Sunsetting**) We agree that rules should not be subject to sunsetting (at [10.101]) because sunsetting can and does create uncertainty, affects existing rights and expectations and is arbitrary in its timing. We also would oppose rules being time-limited. if some kind of formal re-assessment was considered necessary, a compulsory review after a set period (say, 5 years) would be preferable.

Paragraph b.

We strongly support power to make such instruments being conferred on ASIC, for the reasons set out in [10.88] of the Interim Report. That said, we also agree that ASIC should be supported in its rule-making role by an advisory body, similar to the former Corporations and Markets Advisory Committee (but ideally with a more prescriptive requirement for ASIC to take account of the views and recommendations of the advisory body). An alternative would be to reverse the roles so that there was a new body responsible for formulating rules which is required to consult with ASIC (among others).

We also believe and submit that ASIC should have separate powers in relation to rules.

The first case is transitional. No matter how thorough and carefully assessed, it is highly likely that, if and when introduced, the thematic rules will inadvertently fail to include or adversely alter the effect of some of all the 'hundreds of legislative instruments that currently contain alternative regulatory regimes' (at [10.85]). ASIC should have power to quickly address any such anomalies if and when satisfied that they exist. This power would be similar to the emergency power contemplated in s1099 of the Prototype legislation (without the obligation to restrictions and notification obligations set out there).

The second case is more general. As has been evidenced again and again, the Act cannot foresee every situation or development in financial markets, services and products. Quite often, the issues in question develop gradually as a result of market and product innovations. Just as often, the issues are very specific, temporary or highly technical. We think these kind of matters could arise for the Act itself - not just the thematic rules - even where 'prescriptive detail' is removed from the Act. Therefore, we submit that ASIC should also have a general power to grant exemptions and modifications to individuals or classes in relation to both the Act and any rules. ASIC could be required to assess the regulatory benefits and detriments of providing the relief (as it does now) and also to assess whether and when a rule (or amendment to a rule) is required to address the issue rather than an exemption or modification. Such power to grant 'bespoke' exemptions and modifications (or otherwise amend the thematic 'rules' for particular individuals or classes) would need to be carved out of any broader consultation requirements (such as those under s17 of the Legislation Act), to enable ASIC to readily respond to a relief application.

Question A18:

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

Summary

We support the continued inclusion of an objects clause in Chapter 7 of the Corporations Act. However, it is not clear to us that the current objects in section 760A are deficient, or that the insertion of norms of conduct as objects would helpful in addressing the key the problems identified with Chapter 7.

Priority should be given to simplifying, clarifying and rationalising the structure and content of the substantive obligations, rather than adding an additional layer of normative expectations.

If it is considered desirable to include norms of conduct as objects, these should be considered as part of the broader review and revision of Chapter 7, and any new norms should be clearly related to the substantive provisions to avoid uncertainty about their intended meaning.

Purpose of objects clauses

As the ALRC notes (at [13.30]-[13.31]) the inclusion in legislation of a statement of objects which legislative provisions are intended to achieve can assist in the interpretation of those provisions in the case of

uncertainty or ambiguity.[2] However, an objects clause would not control clear statutory language and 'substantive provisions that are clear in their operation would be unaffected' (ALRC at [13.31]). Ideally, the substantive provisions in Chapter 7 would be sufficiently clear in their operation so that recourse to the objects clauses is unnecessary. In considering how the provisions could be reframed or restructured, the ALRC may wish to consider how to clarify the provisions so as to reduce the need to have recourse to objects clauses.

Is the current objects clause in section 769A deficient?

Chapter 7 of the Corporations Act currently includes the following objects clause in section 760A:

> **760A Object of Chapter**
>
> The main object of this Chapter is to promote:
>
> (a) confident and informed decision making by consumers of financial products and services while facilitating efficiency, flexibility and innovation in the provision of those products and services; and
>
> (aa) the provision of suitable financial products to consumers of financial products; and
>
> (b) fairness, honesty and professionalism by those who provide financial services; and
>
> (c) fair, orderly and transparent markets for financial products; and
>
> (d) the reduction of systemic risk and the provision of fair and effective services by clearing and settlement facilities.

Section 760A has been referred to by the courts on a number of occasions in order to determine the intended application of various provisions in Chapter 7. Courts have said that the objects clause indicates a central intent to protect consumers of financial services:

> It is clear that protection of consumers is central, but the object recognises that such protection and the minimisation of risk is facilitated in a number of ways: by the promotion of fairness, honesty and professionalism by 'those who provide financial services'; by ensuring there is transparency in the market and by reducing systemic risk. The interrelationship between the subparagraphs of s 760A is to my mind obvious. Consumers will have an increased confidence in making decisions about financial products and services if those who provide financial services act with fairness, honesty and professionalism. So too systemic risk is reduced if there is fairness, honesty and professionalism in the industry.[3]

Courts appear to have been able to identify the objects of Chapter 7 without difficulty. It is not clear that section 760A is deficient as a statement of those objects. The difficulty has been rather in the complexity and uncertainty of the substantive provisions, as well as misconduct by some financial services providers which has resulted either from disregard or misunderstanding of their legal obligations. We doubt that additional or different objects for Chapter 7, whether or not expressed as norms, would have resulted in more compliance with the substantive provisions.

Should norms be included as objects?

The ALRC considers that the inclusion of certain 'norms' as an objects clause 'may assist in any transition to a more principles-based approach' (at [13.32]).

In our view, norms of conduct are not apt as expressions of objects of a legislative regime. Norms are statements of expected conduct, rather than objects the required conduct is intended to achieve. Norms could be expressed as objects by stating that the relevant provisions are intended to encourage or ensure

[2] Statutory Interpretation in Australia (9th ed) at 4.63.
[3] Australian Securities and Investments Commission (ASIC) v Hutchison (2020) 145 ACSR 420 (Federal Court of Australia) per Banks-Smith J at [74].

conduct that is encapsulated in the norms. But even in this case, it would be more appropriate for the objects to clearly set out why conduct that conforms to the norms would be desirable, rather than merely stating norms of conduct to be followed. While the desirability of certain norms may be self-evident, conceptually objects should be expressed as aims intended to be achieved by the legislation, rather than merely re-statements of conduct obligations.

<u>Priority should be given to fixing the substantive provisions</u>

The ALRC notes that the 'current law concerning conduct obligations on financial services entities is unnecessarily complex' (at [13.21]), and that among other measures, 'one means of assisting users to navigate this legislative morass would be to introduce a form of signposting or signalling as to the fundamental norms that underlie the various conducts obligations' (at [13.22]).

In our view, if effort is to be made to reduce unnecessary complexity, it would be best directed towards simplifying and clarifying the substantive obligations so that they are no more complex than necessary, are coherent, clear, and concise. It should be clear from the legislative drafting what conduct is expected of financial services providers and what the provisions are intended to achieve.

A significant amount of re-organisation, clarification and re-writing of Chapter 7 will be required to make the conduct obligations clear and easy to navigate and understand. It would be preferable to consider the objects of each set of obligations at the same time. Rather than including a single statement of objects covering all of Chapter 7 (with or without annotation referencing specific provisions as suggested by the ALRC at [13.39]), it may be preferable to include separate objects for individual parts of the chapter after it has been organised in a more coherent and clear way, to better reflect the intention of each part. The relationship between the objects and the substantive legal obligations should also be made clear.

The inclusion of norms as additional objects would not address the problems identified with Chapter 7, and may unnecessarily overlap with the substantive obligations. However, if it is considered desirable to include a simple outline of the key conduct obligations by way of a set of norms, we think it would be preferably to set this out clearly as a summary or outline of the relevant obligations, either in a single provision or in the various parts of the Chapter to which they relate. But this would be a summary or outline of the obligations and not a statement of 'objects'.

Question A19:

What norms should be included in such an objects clause?

<u>Summary</u>

If norms are to be included in an objects clause for Chapter 7, we do not object in principle to those put forward by the Financial Services Royal Commission.

However, we agree with the ALRC that 'obey the law' is redundant, and careful consideration should be given to the way the norms are expressed and related to the substantive conduct obligations, to ensure that they achieve the objective of clarifying the purpose of those substantive provisions, and do not add further confusion through ambiguity as to the obligations they are intended to encapsulate or reflect.

<u>The six norms</u>

The norms identified by the Financial Services Royal Commission (ALRC at [13.36]) are not objectionable as general statements of norms of conduct that financial services providers should adhere to.

We agree with the ALRC's observation that the first norm, 'obey the law', is redundant (at [13.37]) and on that basis it is unnecessary to include it in any statement of objects for Chapter 7.

The other norms identified reflect various aspects of the existing law. To that extent, they will overlap with the existing obligations, but in the form articulated by the Financial Services Royal Commission, they lack the detailed provisions in those obligations which define their scope and extent of operation. If the norms are to be included in an objects clause, consideration would need to be given to how the norms are expressed and related to the substantive obligations.

Particular consideration would need to be given to those norms that do not have direct analogues in the current substantive obligations – specifically the norm to 'provide services that are fit for purpose' and to 'deliver services with reasonable care and skill'. While there are a number of obligations in Chapter 7 which may be directed to a similar aim or would overlap with these norms, there is no general obligation to do either of these things in all circumstances in which financial services are provided. The inclusion of these norms without amendment of existing obligations could therefore raise questions as to whether they are intended to introduce new substantive obligations (which we note the ALRC considers is not necessary, at [13.29]).

The final norm stated, 'when acting for another, act in the best interests for that other', begs the question as to when financial services providers act for another, and so when this norm will apply and what it requires. In many instances, a financial services provider, when acting for another, is not acting for their customer but acts as agent for or representative of a principal, who is often another financial services provider or financial product issuer. We do not think this norm is intended to articulate the agent's obligation to their principal. It is presumably directed to conduct towards customers. In that context, the obligation to act in a client's best interests currently applies only in the context where personal advice is provided to a retail client (section 961B). If the intention of the norm is to apply more broadly where financial services are provided to customers, this would not reflect the current legal obligations. There would therefore be a mismatch between the norm and the obligations of financial services providers. Further consideration should therefore be given to the scope and application of this norm, if it is to be included in an objects clause, to ensure it does not create uncertainty or ambiguity as to whether it is intended to introduce new legal obligation on financial services providers which currently do not apply.

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

Summary

The words 'efficiently, honestly and fairly' were originally introduced into Australian law as a licensing requirement, to replace the existing 'fit and proper person' test.[4] They were intended to relate to the general character of a licensee, rather than to apply to specific conduct of licensees. The language was (and remains) inappropriate for evaluating particular conduct.

It is also important to bear in mind that s912A(1)(a) does not impose obligations to act efficiently, honestly and fairly; it instead imposes an obligation '*to do all things necessary to ensure*' that the licensee's financial services are provided efficiently, honestly and fairly. Interpreted literally, this is an impossibly high bar. There will always be inefficiency, dishonesty and unfairness; and it will always be possible, with the benefit of hindsight, to think up steps that might have been taken to prevent such conduct. It is poor legislative

[4] The history is explained by Young J in *Story v National Companies and Securities Commission* (1988) 13 NSWLR 661 from 669. See also the background provided by Latimer, P in *'Providing financial services 'efficiently, honestly and fairly'* (2006) 24 C&SLJ 362.

practice to impose an obligation that is incapable of being met, and which can lead to draconian fines if breached.

A more appropriate obligation would be to require licensees *'to take reasonable steps to ensure that…'* .[5] Considering such an amendment would appear to be beyond the scope of the current review. However, it is important not to lose sight of the fundamental flaws in this provision when considering how it might be amended.

In response to the particular questions in proposal A20:

- The words 'efficiently', 'honestly' and 'fairly' should not be separated because the compendious reading of these words, as suggested by Young J in *Story*, better reflects both:
  - the history of this obligation; and
  - the fact that is an obligation '*to do all things necessary to ensure*', where the 'efficiency' obligation can play a role in modifying the extreme steps that might otherwise be 'necessary' to 'ensure' that no employee or agent is ever dishonest or acts unfairly.
- In so far as the words are separated, they should be defined as legal obligations which are capable of being understood.
- In the alternative, a note containing examples will go some way to mitigating the effect of imposing obligations of this nature.

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

A literal obligation to do all things necessary to prevent an employee or agent ever acting inefficiently, dishonestly or unfairly is irreconcilable with operating a financial services business. It would require every act of every employee or agent to be subject to many layers of scrutiny before being performed. It is an impossible standard.

There is therefore much merit to the observation of Young J that '*it is impossible to carry out all three tasks concurrently*'.[6] This is particularly apparent in the tension between 'efficiency' and the other 2 obligations.

We acknowledge the competing comments of Allsop CJ and O'Bryan J, cited in the Interim Report (at 514), and in particular the observation of O'Bryan J that the words efficiently, honestly and fairly '*are not inherently in conflict with each other*'. We have 2 comments on that observation.

- Although it is true that the obligation to act honestly is not inherently in conflict with the other obligations, there can be a conflict between 'fairness' and 'efficiency' when pursuing the former consumes disproportionate time and resources.[7]
- The conflict is much more apparent when one remembers that the obligation is '*to do all things necessary to ensure that*' financial service are provided efficiently, honestly and fairly. 'Ensuring' that employees and agents are never dishonest or unfair would be unsustainably inefficient. The inclusion of 'efficient' could therefore bring a degree of commerciality to considerations of what is 'necessary'.

We therefore propose that the terms 'efficiently, honestly and fairly' should not be separated. Instead, we suggest that s912A(1)(a) be amended to read either:

> *A financial services licensee must act reasonably to ensure that the financial services covered by the licence are provided honestly and fairly;*
>
> or, in so far as that suggestion is considered beyond the remit of the current review:

[5] Cf the language used in workplace health and safety legislation.

[6] *Story* at 672

[7] Although we also acknowledge that 'efficiently' has at times being interpreted to mean 'effective to achieve the intended purpose', rather than referring to the amount of effort or resources required to achieve that purpose.

> *A financial services licensee must do all things necessary to ensure that the financial services covered by the licence are provided honestly and fairly, having regard to the need to conduct its business efficiently.*

In so far as it is proposed to impose distinct, separate obligations to act efficiently, honestly and fairly, consideration should first be given as to whether there is in fact a need to impose further legislative duties, given the plethora of existing obligations on licensees. This is considered further below.

Paragraph b. -replacing the word 'efficiently' with 'professionally'

For the reasons explained above, and as indirectly observed by Young J in *Story,* the word 'efficiently' should be understood as qualifying the otherwise impossible obligation to do *all things necessary* to ensure that financial services are provided honestly and fairly. We therefore do not recommend that it be replaced with 'professionally'.

Furthermore, in the context of the numerous other statutory, common law and (in some cases) equitable obligations imposed on licensees, it is unclear what misconduct would be averted by imposing a further obligation to act 'professionally' (or 'competently' or 'efficiently').

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

We support the proposal to include examples of conduct that would not be 'fair'. We would further support a proposal to define the conduct that is intended to be caught by the prohibition.

The Interim Report quotes the following examples of conduct that has been described as 'unfair':

- Bias
- Dishonesty
- Injustice
- Being unreasonable
- Not being even-handed
- Exploiting another's vulnerability
- Failing to have sufficient regard to another's interests
- Seeking to influence a customer without regard to their interests
- Lack of reciprocity
- Engaging in misleading conduct

These examples show that 'fairness' does not in fact have any particular meaning, but that 'unfair' is a general word used to describe conduct of which a person disapproves. The ubiquitous child's complaint: 'that's not fair' is also an accurate reflection of its adult usage. As Professor Birks observed, in a quote cited in the Interim Report (at 13.75), the concept of fairness '*is so unspecific that it simple conceals a private and intuitive evaluation'.*

A standard which enables any regulator or judge to sanction conduct of which they disapprove, without needing to apply any legal standard separate from their own disapproval, is inimical to the rule of law. It is therefore an inappropriate term for imposing a legal obligation, the breach of which (or the failure to report a breach of which) exposes a licensee to very high penalties.

In the context of existing legal prohibitions on dishonest, misleading, unconscionable or negligent conduct, the threshold question should be: what additional conduct is being sought to be prohibited by an obligation to act fairly? Many of the definitions of unfair conduct are already covered by existing prohibitions.

- If it is thought that there is a gap in the existing prohibitions, then examples (or, preferably, definitions) can indicate the behaviour that is intended to be caught by the additional obligation to act fairly.
- If it is intended to use unfairness to replace existing prohibitions (such as that for unconscionable conduct), then that should be stated expressly.

Proposal A21

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

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

b. to maintain the competence to provide the financial services (s912A(1)(e));

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

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

We agree with the proposal to remove these provisions, albeit for a different reason from that proposed in the Interim Report.

The law already imposes obligations on licensees to avoid conflicts, not be negligent and (self-evidently) to comply with numerous statutory obligations. It is an exercise in redundancy for the law:

- to impose certain obligations; and, separately,
- to require an entity to be able to comply with those obligations.

The systems which a company has in place to comply with its legal obligations should be a factor that is relevant in determining the punishment for breach of those obligations. It is also quite legitimately a matter for regulatory guidance and inquiry. It should not however be a separate legal obligation in itself.

Proposal A22

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

We support this proposal, and the adoption of the first path for achieving it, for the reasons given in the Interim Report.

With respect to the second path we also note that the 'efficiently, honestly and fairly' obligation is not an obligation to act in those ways, but to do all things necessary to ensure that the relevant financial services are provided in those ways (a different form of obligation to the obligation in s 12CB of the *Australian Securities and Investments Commission Act 2001* (Cth)).

That said, we reiterate our comment in our submission on Proposal A20 - in the context of existing legal prohibitions on unconscionable conduct, the threshold question should be: what additional conduct is being sought to be prohibited by an obligation to act fairly? If it is thought that there is a gap in the existing prohibitions on unconscionability, then examples (or, preferably, definitions) can indicate the behaviour that is intended to be caught by the additional obligation to ensure that financial services are provided fairly.

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 support this proposal for the reasons given in the Interim Report. It is our experience that the proliferation of similar provisions unnecessarily complicates the conduct of litigation in this area.

We further submit that, in any consolidated provision, unintentionally misleading or deceptive statements or conduct should not be offences or contravene civil penalty provisions.[8]

[8] For example, s12DB of the ASIC Act (read with s12GBA) makes unintentionally misleading conduct a civil penalty provision.