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Australian Law Reform Commission
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To the Australian Law Reform Commission

ALRC Interim Report A - Financial Services Legislation

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on Report A - Financial Services Legislation ALRC 137 (Report A).

Summary

AFMA is party to the near unanimous and obvious consensus view that was reported in *Background Paper FSL1 Legislative Framework for Corporations and Financial Services Regulation Initial Stakeholder Views* that the law in this area is 'too complex' and in need of simplification. Report A provides ample evidence in general that action is needed to address the complexity of the law under review. Report A provides an excellent analysis of the problems with the *Corporations Act 2001* and related financial services legislation as 'law'. AFMA would like to see policy work taken forward on many of the issues raised through a substantive policy process.

AFMA generally supports the Recommendations made in Report A based on the justifications in the report.

AFMA's central concern with Report A is that the proposals could be taken forward as law reform measures in isolation. The ALRC review alone cannot produce financial services policy reform proposals as a standalone exercise as this goes beyond the mandate under the Terms of Reference where they would result in substantive policy changes. The Report A is replete with much useful material, which provides a very valuable commentary and critique of the law both from a form and policy perspective.

AFMA comments on the Proposals are therefore simple and are in the nature of yes it is sensible to say there is a problem here which needs fixing, but if you make this change in isolation it has significant policy implications and affects other parts of the way the law works so we need to take them forward as policy review issues. This industry recoil from the ambition of the Report A proposals is not based on a conversative "better the devil you know" reaction but rather a positive desire to take the opportunity to integrate good law design into a continuing process which avoids ad hoc accretions and tinkering on a piecemeal basis.

We make observations at the end of these comments on how policy reform proposals could be taken forward. For AFMA, it is devising the process for reform, which is a subject for the next two ALRC interim reports that is the hardest task facing the ALRC, given the time it would take and the dangers of it being knocked off course. This is a matter in which we have a vital interest and much experience and look forward to contributing to the consultations around it.

AFMA concludes with saying that Report A identifies the problems with the form of the law and generally makes sensible recommendations on how to address those problems. Where the report identifies drafting issues and offers proposals which affect policy then we need to put those proposals into a wider holistic policy review process.

Recommendations

The Recommendations are all supported for the reasons cited in Report A.

ALRC Recommendation	**AFMA view**
Recommendation 1: Section 5(3) of the Australian Securities and Investments Commission Act 2001 (Cth) should be amended to remove reference to non-existent Part 1.3 of the Corporations Act 2001 (Cth).	Supported
Recommendation 2: The definitions of all words and phrases that are not used as defined terms in the Corporations Act 2001 (Cth) should be removed from that Act.	Supported
Recommendation 3: Section 9 of the Corporations Act 2001 (Cth), and ss 5 and 12BA(1) of the Australian Securities and Investments Commission Act 2001 (Cth), should be amended to remove all qualifications that definitions or rules of interpretation apply unless a 'contrary intention appears'.	Supported
Recommendation 4: Section 9 of the Corporations Act 2001 (Cth) should be amended to remove the definitions of 'for' and 'of'.	Supported
Recommendation 5: Section 5C of the Corporations Act 2001 (Cth) and s 5A of the Australian Securities and Investments Commission Act 2001 (Cth) should be repealed.	Supported

Recommendation 6: All definitions that duplicate existing definitions in the Acts Interpretation Act 1901 (Cth) should be removed from the Corporations Act 2001 (Cth) and the Australian Securities and Investments Commission Act 2001 (Cth).	Supported
Recommendation 7: The Corporations Act 2001 (Cth) should be amended to include a single glossary of defined terms.	Supported
Recommendation 8: Section 7 of the Corporations Act 2001 (Cth) should be replaced by a provision that lists where dictionary provisions appear and the scope of their application.	Supported
Recommendation 9: The Corporations Act 2001 (Cth) should be amended so that the heading of any provision that defines one or more terms (and that does not contain substantive provisions) includes the word 'definition'.	Supported
Recommendation 10: The Office of Parliamentary Counsel (Cth) should develop drafting guidance to draw attention to defined terms each time they are used in corporations and financial services legislation.	Supported
Recommendation 11: The Office of Parliamentary Counsel (Cth) should investigate the production of Commonwealth legislation using extensible markup language (XML).	Support
Recommendation 12: The Office of Parliamentary Counsel (Cth) should commission further research to improve the user-experience of the Federal Register of Legislation.	Supported
Recommendation 13: Regulation 7.6.02AGA of the Corporations Regulations 2001 (Cth) should be repealed.	Supported

Questions and Proposals

Empirical Data

Question A1*: What additional data should the Australian Law Reform Commission generate, obtain, and analyse to understand:*

a. *legislative complexity and potential legislative simplification;*
b. *the regulation of corporations and financial services in Australia; and*
c. *the structure and operation of financial markets and services in Australia?*

AFMA Comment on A1

AFMA agrees with the five overarching principles guiding the report and much of the analysis of the problems with the current law that are widely recognised.

Some of the proposals touch upon issues of substantive public policy importance in the financial services sphere. While we agree they need attention, the approach based on our past experience with major law reform (such as the *Financial Services Reform Act 2001*) may cause more problems for industry than it solves with issues of considerable policy complexity. AFMA believes that the issues touched on in the proposal deserve policy reform review that take in a much broader context of the way the various parts of the law work at present and the problems highlighted in the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Final Report that go beyond Chapter 7 of the Corporations Act (Chapter 7).

In essence we are highly concerned that you will set in train a process of pulling apart a very complex watch mechanism with complications of dazzling complexity and substitute in new cogs and springs without questioning why these complications were built-in.

Structural controls on the ability to create additional regulation inconsistent with the law design principles and processes for the review of existing regulations need to be considered from a more holistic policy perspective. The development of complex, byzantine laws through constant overlaying of legislative and subordinate law reform and baroque elaborations through administrative rules needs to be countered. Having an examination and review regime based on the five ALRC design principles when changes to the law are proposed would be a welcome development.

Definitions

Question A2*: Would application of the following definitional principles reduce complexity in corporations and financial services legislation?*

When to define:

a. *In determining whether and how to define words or phrases, the overarching consideration should be whether the definition would enhance readability and facilitate comprehension of the legislation.*
b. *To the extent practicable, words and phrases with an ordinary meaning should not be defined.*
c. *Words and phrases should be defined if the definition significantly reduces the need to repeat text.*
d. *Definitions should be used primarily to specify the meaning of words or phrases, and should not be used to impose obligations, tailor the application of particular provisions, or for other substantive purposes.*

Consistency of definitions

e. *Each word and phrase should be used with the same meaning throughout an Act, and throughout all delegated legislation made under that Act.*
f. *Relational definitions should be used sparingly.*
g. *To the extent practicable, key defined terms should have a consistent meaning across all Commonwealth corporations and financial services legislation.*

Design of definitions

h. *Interconnected definitions should be used sparingly.*
i. *Defined terms should correspond intuitively with the substance of the definition.*
j. *It should be clear whether a word or phrase is defined, and where the definition can be found.*

AFMA Comment A2

AFMA supports the definition principles set out in Question A2.

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

AFMA Comment A3

AFMA supports the principle that defined terms, such as 'financial product' and 'financial service' should be consistent across related financial services laws.

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),*
d. *and ss 12BAB(2) and (10) of the Australian Securities and Investments Commission Act 2001 (Cth);*
e. *remove the incidental product exclusion by repealing s 763E of the Corporations Act 2001 (Cth);*
f. *insert application provisions to determine the scope of Chapter 7 of the Corporations Act 2001 (Cth) and its constituent provisions; and*
g. *consolidate, in delegated legislation, all exclusions and exemptions from the definition of 'financial product' and from the definition of 'financial service'.*

AFMA Comment A4

Proposal A4 is not supported. This proposal in isolation would produce a very confused situation. While these definitions are problematic, there are better means to address the problems with them. This proposal highlights our prime concern that disentangling of these definitions, which essentially act as the means to give ASIC the power to regulate areas and persons, needs a more thorough going policy review process. These changes alone would raise many practical problems for ASIC and industry. Such a change would be time consuming and costly for all involved and a clear path through for empowering ASIC in a better way and transitioning industry needs to be thought through.

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)).*

AFMA Comment A5

This proposal has substantive policy implications. This proposal should be included in a list of policy issues for a holistic policy review process.

Proposal A6*: In order to implement Proposal A3:*

a. *reg 7.1.06 of the Corporations Regulations 2001 (Cth) and reg 2B of the Australian Securities and Investments Commission Regulations 2001 (Cth) should be repealed;*
b. *a new paragraph 'obtains credit' should be inserted in s 763A(1) of the Corporations Act 2001 (Cth) and in s 12BAA(1) of the Australian Securities and Investments Commission Act 2001 (Cth); and*
c. *a definition of 'credit' that is consistent with the definition contained in the National Consumer Credit Protection Act 2009 (Cth) should be inserted in the Corporations Act 2001 (Cth) and in the Australian Securities and Investments Commission Act 2001 (Cth).*

AFMA Comment A6

This proposal has substantive policy implications. This proposal should be included in a list of policy issues for a holistic policy review process.

Disclosure

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

AFMA Comment A7

This proposal has substantive policy implications. This proposal should be included in a list of policy issues for a holistic policy review process.

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

This proposal has substantive policy implications. This proposal should be included in a list of policy issues for a holistic policy review process.

Exclusions, Exemptions, and Notional Amendments

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.*

AFMA Comment A9

AFMA has long advocated that the plethora of modifications to the current law that were done under the various regulation modification provisions and under ASIC administrative discretions should be uplifted into the law as a matter of priority. This is an obvious starting point.

Our response to this question goes back to the law design issue at the heart of Chapter 7. While the proposal looked at in isolation has merit this is a prime example of why just introducing this type of constraint is inconsistent with the way Chapter 7 was drafted.

The style of the *Financial Services Reform Act 2001* (FSRA) was to set out the general principles with the detail to be filled in by regulations and by policy. The FSRA was intended to provide a flexible and adaptable framework that encourages innovation and is able to respond to a changing regulatory environment. At the time it was not considered realistic to expect that legislation could be drafted in a way that would be capable of incorporating such change. The idea was that the regulator would be given flexibility to provide clarity and certainty, to prevent unintended consequences, and to promote the objectives of the law. The problem was that the regulator had to exercise discretion to implement the legislation to give sufficient certainty for market

participants, whilst maintaining sufficient flexibility to facilitate innovation and promote business.

To remedy the situation the broad and all-encompassing definitions, such as is exampled by 'derivative', would need to be rethought and new mechanisms devised to attract regulatory oversight and obligations.

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.*

AFMA Comment A10

A new policy body based on the CAMAC model could help maintain the consolidated legislative instrument.

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

a. Should the Corporations Act 2001 (Cth) be amended to insert a power to make thematically consolidated legislative instruments in the form of 'rules'?
b. Should any such power be granted to the Australian Securities and Investments Commission?

AFMA Comment A11

At the end of these comments we suggest a new policy body based on the defunct Corporations and Markets Advisory Committee (CAMAC) model. It could review rule proposals by ASIC and recommend whether they should proceed under a delegated ministerial authority. The delegate could be a senior executive Treasury official.

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

AFMA Comment A12

AFMA agrees that a control and oversight mechanism is needed. We have suggested above a new policy body based on the CAMAC model. It could play a role in scrutinising and quality controlling delegated legislation.

Definition of 'Financial Product Advice'

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

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

b. *substitute the current use of that term with the phrase 'general advice and personal advice' or 'general advice or personal advice' as applicable; and*
c. *incorporate relevant elements of the current definition of 'financial product advice' into the definitions of 'general advice' and 'personal advice'.*

AFMA Comment A13

This proposal has major policy implications, and it would be far too simplistic to tinker with it as a technical definitional problem. For example, the implications of the distinction between 'general advice' and 'personal advice' go to the heart of one of the biggest challenges facing the financial industry in Australia regarding how to provide affordable financial advice and it underlies many existing business models and arrangements.

This issue is a fundamental importance and requires careful policy attention. It should be included in a list of policy issues for a holistic review process.

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

AFMA Comment A14

The above response to Proposal A13 applies equally to Proposal A14.

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

AFMA Comment A15

Proposal A15 raises fundamental questions about the way Chapter 7 operates and is of great importance. The regulation of 'general advice' closely affects how businesses are currently organised to comply with the law on financial services advice. A change to this provision needs to form part of a holistic review process.

Definitions of 'Retail Client' and 'Wholesale Client'

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

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

ii. *ii. the product value exception in sub-s (7)(a) and the asset and income exceptions in sub-s (7)(c); or*

b. in some other manner?

AFMA Comment A16

Question A16 raises again fundamental questions about the way Chapter 7 operates. Points about what is the right scope of retail investor protection and disclosure laws and the way insurance and superannuation is combined with investment product investor protection come into questioning and then what consumer protection if general insurance products, superannuation products, RSA products, and traditional trustee company services should apply would need to be addressed.

The law should not be amended in this way, it needs to form part of a holistic review process.

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

AFMA Comment A17

As with Question 16, the law should not be amended in this way, it needs to form part of a holistic review process.

Conduct Obligations

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

AFMA Comment A18

AFMA supports the approach that the law should state what fundamental norms of behaviour are being pursued to give interpretive guidance to particular and detailed rules. The current obligation to act 'efficiently, honestly and fairly' has proved to be difficult to understand and interpret from a compliance perspective by industry and along with 'unconscionable' conduct are used as catch all enforcement tools when more specific offence provisions are not identified by the regulator.

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

AFMA Comment A19

This is a question, which as the Report A commentary indicates, requires considerably more thought and debate, so again is subject to the need for a further policy review process. The Royal Commission into Misconduct in the Banking, Superannuation and

Financial Services Industry Final report's identification of existing norms are a good starting point for discussion with the exception of the redundant "Obey the law":

1. Do not mislead or deceive
2. Act fairly
3. Provide services that are fit for purpose
4. Deliver services with reasonable care and skill
5. When acting for another, act in the best interests of that other.

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.

AFMA Comment A20

Proposal A20 fits again into an area of great interest to industry and importance. AFMA agrees with the analysis and thinking behind the proposal. Consistent with our general approach, reform of this obligation needs to part of a holistic review process.

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

a. to have in place arrangements for the management of conflicts of interest (s 912A(1)(aa));
b. to maintain the competence to provide the financial services (s 912A(1)(e));
c. to ensure representatives are adequately trained (s 912A(1)(f)); and
d. to have adequate risk management systems (s 912A(1)(h)).

AFMA Comment A21

Reform of these requirements needs to part of a holistic review process.

Unconscionable conduct

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

AFMA Comment A22

The doctrine of unconscionable conduct developed over several hundred years in the courts of equity. It is a mechanism whereby equity may intervene to undo a state of affairs which it would offend against conscience to permit to continue, irrespective of the legality of the situation at common law.

The traditional equitable doctrine provided, relief on the basis of unconscionable conduct being available where one party to a transaction is at a special disadvantage in dealing with the other party because of illness, ignorance, inexperience, impaired faculties, financial need or other circumstances affecting a person's ability to conserve their own interests, and the other party unconscientiously takes advantage of the opportunity thus placed in their hands. It now applies in the law more generally in situations such as institutional markets where counterparties have comparable economic power and access to information.

For AFMA the most problematic issue associated with unconscionable conduct in this part of the law is that the general "attempt' provision (s12GBCL) can be applied to it so that a person can be found liable for "attempted unconscionable conduct", which is in our view akin to a thought offence. This is not examined in the Report A commentary. In our view s12GBCL should not apply to s12CC of the ASIC Act.

In addition, attention is also drawn to the judgment in *Australian Securities and Investments Commission v Westpac Banking Corporation (No 2)* [2018] FCA 751. In that case Justice Beach of the Federal Court of Australia concluded that Westpac had engaged in unconscionable conduct under section 12CC of the ASIC Act. Beach J constrained his analysis to the confines of the normative standards set out in financial markets law. He therefore keeps the subjective considerations of the nature of good conscience and fairness out of the analysis. Beach J decided that "Westpac's conduct was against commercial conscience as informed by the normative standards and their implicit values enshrined in the text, context and purpose of the ASIC Act specifically and the Corporations Act generally." This is important as he confines standards away from excursions into consideration of the nature of good conscience or fairness.

Misleading or deceptive conduct

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*.

AFMA Comment A23

AFMA supports this proposal in principle, but it once again opens upon the broader issue of why duplicative provisions need to be in the ASIC Act and the need for this matter to be part of a holistic review process.

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

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

AFMA Comment A24

Reform of the 'best interests' provisions needs to part of a holistic review process.

Process needed for new legislative architecture

Report A comments that implementing the legislative architecture proposed would be a significant program of work. AFMA agrees with the ALRC that extensive legislative reform would be needed, which past industry experience has demonstrated will result in high transition and implementation costs. The current law is the result of successive reform waves which had the policy objectives of satisfying community expectations of the industry as they evolved. Those objectives are not being challenged by the envisaged reforms. The aim of a reform process would be to produce an efficient regulatory regime which does not result in disruptive change in the way that introduction of the *Financial Services Reform Act 2001* did, and is in harmony with community expectations for the financial services industry as expressed in current law.

The key comment from AFMA is that the proposals in Report A have merit but would be problematic and most concerning to industry if taken forward alone, and more contextual policy work needs to be done. AFMA considers identifying what policy changes are needed is the easier part of the exercise in addressing the widely recognised problems with the financial services legislation.

AFMA believes that a more holistic policy process is needed to take the Report A proposals forward. The Treasury as the responsible policy department is clearly the reference point for coordinating such a process. To aid it a body of continuing expertise to give coherence and rationality to integrating reform ideas into a coherent body of law would be highly desirable.

AFMA believes the process needed to take proposals forward could be through a body modelled on the former Corporations and Markets Advisory Committee (CAMAC), which was abolished in 2015. Its abolition was in our view a false economy given the drag that inefficient regulation has on national productivity. The objective, methodical approach of CAMAC was valued by market participants and would be a fine way to take the ALRC's work and findings forward. Importantly, it is necessary that an oversight body is able to identify at the start the endpoint outcomes and the steps and transition path required in a legislation plan to get to the end destination which avoids major disruption and uncertainty for industry. The value in having an oversight body is that corporate memory and expertise can be maintained through political cycles and changes in policy department administrative arrangements.

AFMA looks forward to a continuing dialogue with the ALRC as it continues its work on financial services legislation. Please contact David Love either on [redacted] in regard to this letter.

Yours sincerely

[redacted]

David Love
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