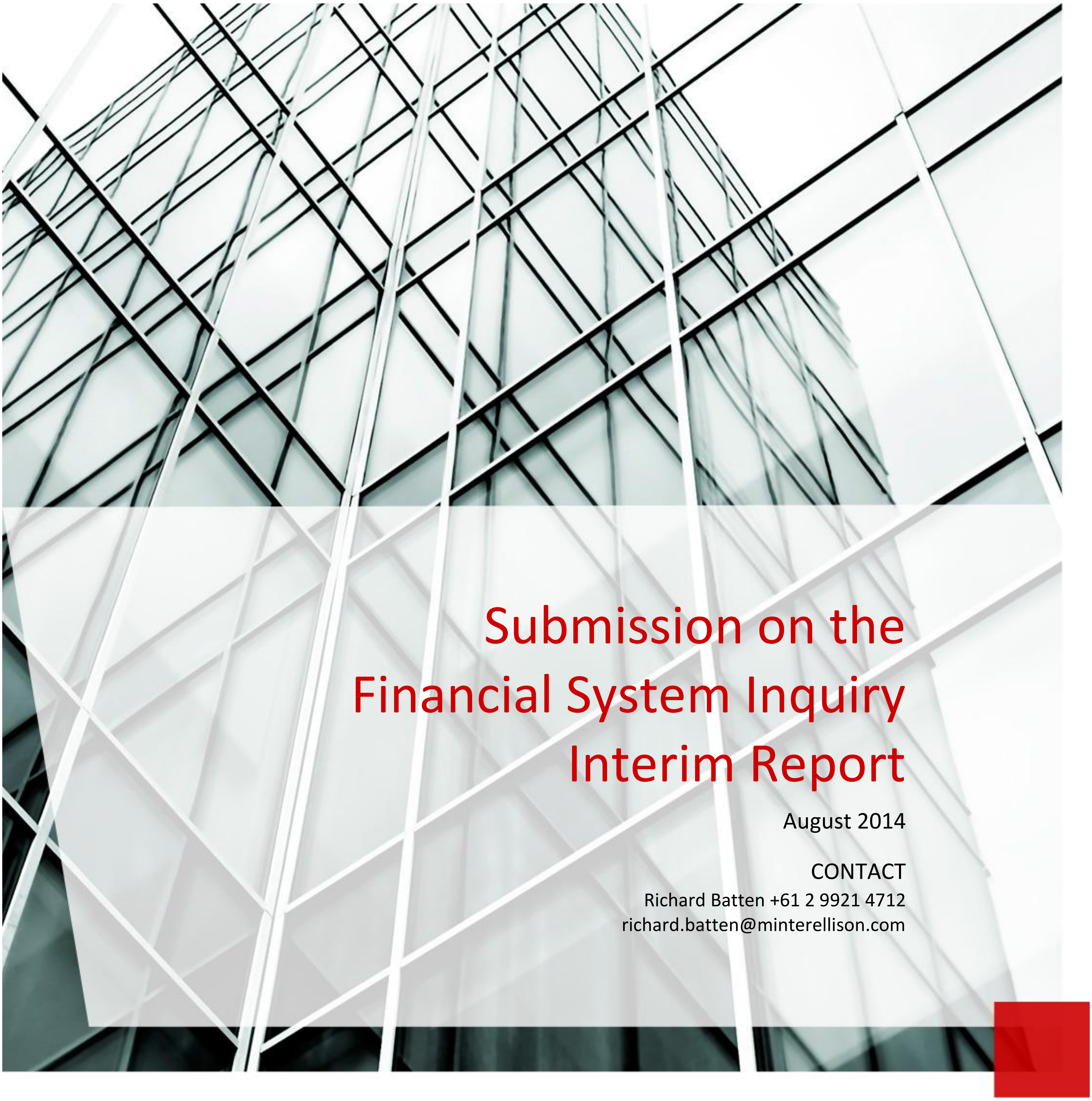

Submission on the Financial System Inquiry Interim Report

August 2014

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Introduction

Minter Ellison is one of Australia's leading commercial law firms. Established in Sydney in 1827, our firm today operates in Australia, Hong Kong, mainland China, Mongolia, New Zealand and the United Kingdom through a network of integrated offices and associated offices.

We understand the challenges that businesses operating in a globalised marketplace face, and offer clients services that are multi-disciplinary and industry facing. Our firm provides high-level strategic and legal advice to local and international corporations, and we are a leading provider of legal services to a wide range of government departments and statutory authorities.

Financial services is one of the core industries on which Minter Ellison is founded – our clients include banks, insurance companies, superannuation trustees, fund managers, custodians, market participants and financial advice firms.

Our firm is therefore well placed to identify issues relevant to this sector and we appreciate the opportunity to make a further submission to the Financial System Inquiry on the issues set out in the Inquiry's Interim Report.

Our submission discusses the concerns raised by the Inquiry, as well as the reforms we believe will address these concerns, taking into account the possible policy responses raised by the Interim Report.

Further information and commentary on issues presented in the Financial System Inquiry will be available at Minter Ellison's blog: http://fsinquiry.minterellison.com/

We would welcome the opportunity to expand on any our submissions and to make further submissions on these or any other issues during the course of the Inquiry. Please contact us if you have any questions relating to our submission.

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Key issues affecting the financial system

We welcome the Interim Report released by the Financial System Inquiry in July 2015 and commend the thorough and broad-ranging nature of the issues canvassed. We particularly acknowledge the Inquiry's willingness to recognise and give serious consideration to the differing concerns of stakeholders in the system.

We have made submissions in relation to many of the questions or potential reforms identified in the Interim Report in the Appendices to this submission which are grouped by subject matter. In some cases, we have also identified other issues which we believe that the Inquiry should be considering.

The following table provides a high level summary of the key issues discussed in the Appendices.

Appendix	Key issues
A. Regulation	• Ensuring regulators have adequate and independent funding is important to the efficient operation of the financial system. • It is critical that regulators are accountable for their performance which needs to be assessed not only against specific goals but also how these goals have been achieved in a manner than promotes efficiency, innovation and competition in the financial system. We have suggested a means by which this could be achieved on page 7. • Consideration should be given to the establishment of a Macroprudential Regulator able to respond to systemic or economic shocks or failures. • We support a single specialist regulator having responsibility for conduct regulation in the financial sector. • There should be a greater emphasis on self-regulation in the financial sector under appropriate oversight as a way of more effectively deploying limited regulatory oversight resources. • Australia's regulatory regime is overly complex which impedes efficiency and regulatory certainty and reduces confidence in the regulatory system by both participants and consumers. • Reviewing the financial system should not be left until a crisis occurs. A mechanism for regular review at least every 10 years should be established. • Better consultation on regulatory reform initiatives is critical to the efficient operation of the financial system.
B. Regulatory perimeter	• Our key recommendation relating to the establishment of a Macroprudential Regulator is discussed in Appendix A.
C. Consumer protection	• We agree the current disclosure requirements need to be improved which a focus on the disclosure a client needs at the time they need it. We therefore propose four disclosure principles on page 13. Key elements include making product disclosure statements accessible but limiting them to investment-related products. • We oppose any limitation on the types of products available to retail clients or requiring product issuers to assess the suitability of products for individual clients. • Anomalies in the retail client test should be addressed.
D. Banking	• We believe that conservative prudential settings benefit Australia and the financial system. • It is important to address the problem of pro-cyclicality which poses challenges for both boards and regulators.
E. Funding	• We are not convinced that information asymmetry has a material impact on the availability of SME credit and are concerned that regulating business credit more intensely may reduce access to or the affordability of credit for SMEs. • We do not believe that comprehensive credit reporting (CCR) should be made mandatory until the success of the voluntary CCR arrangements that came into effect on 12 March 2014 can be assessed. • The compliance burden for micro-financiers within the not-for-profit and community sector should be streamlined.
F. Financial advice	• Consideration should be given to requiring financial advisers to be a member of an approved professional body. Such bodies should be responsible for setting and raising education, competency and other standards. • We support measures to encourage the provision of scaled advice, including through online tools.

Appendix	Key issues
	• We do not support labelling advisers as 'restricted' or calling general advice 'sales' or 'product information' given the range of circumstances in which general advice may be given and existing measures to preclude inappropriate promotion of general advice services.
G. Financial markets	• We support increasing the limits for prospectus exemptions, so long as other issues are also addressed.
H. Insurance	• We are concerned about certain proposals relating to comparison websites. • Given the importance of disability insurance in reducing welfare costs for the taxpayer, we believe that the Inquiry should be considering how the issues affecting disability insurance can be addressed and how greater disability cover can be encouraged on a sustainable basis. • Arbitrary distinctions between health, life and general insurance should be removed. • The Inquiry should consider the impact of state and territory taxes and levies.
I. Managed investments	• Caution is required before deciding whether to implement the CAMAC recommendations as many may have unintended consequences. • We strongly support the development of an internationally recognised corporate vehicle for managed funds in Australia. However, it is critical that the Johnson Report recommendations are fully implemented if the Australian funds management industry is to be internationally competitive. • The Inquiry should recommend the introduction of an effective product rationalisation regime.
J. Payments	• The government should adopt a 'light touch' approach to regulation of the payment system which incentivises innovation without unduly burdening new entrants to the financial services market.
K. Superannuation	• It is critical that a bipartisan position on superannuation and retirement incomes policy be developed to ensure its success. Consideration could be given to how an independent body could be tasked with adjusting policy settings within a broadly agreed mandate for the system. • While we do not support mandating the use of particular retirement income products, we believe there is merit in considering the introduction of a default option for retirees. • There is a clear need for streamlined administrative arrangements between the superannuation and aged pension systems.
L. Technology and privacy	• We strongly support technology neutral regulation. • Standardised privacy disclosure should be made available to financial sector consumers. • We agree that the Australia's Cyber Security Strategy should be updated in a way that lays the foundation for a strong partnership between government and the private sector.
M. International integration	• Leveraging our domestic capability internationally should be a key goal and this requires reform in the areas of choice of investment vehicle, tax and passporting. • We also believe that more can be done to make our AML/CTF regime more consistent with and to give greater recognition to other global regimes.
N. Governance	• We believe that while the current law regarding the duties of directors of regulated bodies is is appropriate. • However, directors should have the benefit of an effective business judgment rule which extends to protect directors of regulated bodies.
O. External administration	• The insolvent trading regime is overly strict and places an inappropriate burden on directors. A layered insolvent trading regime should be established, introducing a safe harbour defence for listed companies. • The Inquiry should recommend the prohibition of ipso facto clauses while a company is in voluntary administration.

Interim Report
page reference

Appendix A: Regulation

Regulatory funding and independence

The Interim Report has sought submissions on the following matters: 3-113, 3-116-7

- Move ASIC and APRA to a more autonomous budget and funding process, ie:
  - APRA to publish a comprehensive budget proposal ahead of the annual Government budget process.
  - Change to an industry-funding model for ASIC, based on approaches taken in the UK, Canada and other jurisdictions.
- Conduct periodic, legislated independent reviews of the performance and capability of regulators.
- Clarify the metrics for assessing regulatory performance.
- Replace the Ministerial directions power with Statements of Expectations and Intent similar to NZ and require regulators to report annually against them.
- Replace the efficiency dividend with tailored budget accountability mechanisms such as regular audits and reviews to assess the regulators' potential for savings and a requirement that regulators establish and publish appropriate performance and efficiency measures.
- Improve the oversight processes of regulators, eg introduce an Inspector-General of Regulation or a unified oversight authority for financial regulators, combining the roles of the Office of Best Practice Regulation, Auditor-General, Ombudsman and other specialist bodies.

Minter Ellison response

We agree that imposing artificial efficiency dividends is not productive and financial sector regulators should be able to set their budgets based on the level of resources required to ensure consumer and investor confidence without imposing an undue burden on regulated entities or unduly impeding efficiency, innovation or competition in the financial sector. We submit that the total annual budget for each regulator to undertake their role should be set at the outset based on a carefully costed budget proposal and extensive consultation. This process should be undertaken on a periodic basis, for example every five years. Between these reviews, regulators should only be permitted to increase their budget by the average weekly earnings index for salaries and the consumer price index for other expenses, subject to any decision by the Government to provide additional funding (from consolidated revenue not recoverable from industry) if a regulator makes a case for additional funding, for example in the case of an economic emergency.

We acknowledge that there is merit in funding regulators through industry levies in a manner that promotes operational independence. However, we submit that the basis of allocating levies between different types of regulated entities needs to be undertaken very carefully. While size, complexity, risk and benefit are all relevant considerations, other principles will also be important including promoting efficiency, innovation and competition in the financial sector and access to financial services and products by consumers. We also submit that the basis on which AUSTRAC levies are allocated also needs to be reviewed and reconsidered with greater recognition given to the general social benefit arising from anti-money laundering and counter-terrorism financing laws and the significant compliance cost imposed on regulated entities to enable these social benefits to be achieved.

We agree that periodic, legislated independent reviews of the performance and capability of regulators should be conducted based on clear metrics for assessing regulatory performance, including performance against a statement of Government expectations.

We believe that it is critical for regulators to be accountable for their performance and we are not convinced that current mechanisms, such as Parliamentary oversight, achieve this sufficiently. While a Government authority or inspector-general of regulation may assist, we believe that clear accountability against the goals of promoting efficiency, innovation and competition in the financial sector needs to be achieved. We believe that there needs to be a mechanism requiring regulators to justify their conduct when setting policy and guidance or exercising regulatory power similar that the one we suggested in our previous submission and on page 7 of this submission.

Regulatory coordination

The Interim Report has sought submissions on the following matters: 3-120

- Consider increasing the role, transparency and external accountability mechanisms of the CFR:
  - Formalise the role of the CFR within statute.
  - Increase the CFR membership to include the ACCC, AUSTRAC and ATO.
  - Increase the reporting by the CFR.

Minter Ellison response

We support the establishment of a body with macroprudential powers over the financial system and the economy to the extent required to support stability of the financial system (**Macroprudential Regulator**) provided it does not result in a new regulator with its own power to impose requirements on financial system participants. The Macroprudential Regulator should be required to work through existing regulators in undertaking its role. It should however have the power to direct existing regulators to exercise their powers in a particular way required by the Macroprudential Regulator where it determines that is necessary to deal with a current or imminent economic emergency. The circumstances in which the power needs to be carefully defined and should only be able to be exercised for a specified period of time, for example a year, with regulation reverting to the regime in place before the Macroprudential Regulator exercised its power, unless extended by the Macroprudential Regulator within that time.

The Macroprudential Regulator should also be the body tasked with determining whether to APRA's regulatory perimeter on an ongoing basis.

The Macroprudential Regulator's functions should be subject to oversight in the following way:

- The exercise of economic emergency powers should not be subject to disallowance by Parliament but should be subject to oversight by an appropriate Parliamentary committee. The ability to challenge the exercise of such powers in court should be strictly limited unless exercised corruptly.
- The exercise of regulatory perimeter powers should be subject to disallowance by either House of Parliament and normal oversight by the courts.

We question whether that the Macroprudential Regulator should be the Council of Financial Regulators (**CFR**) or another body. We note that the Government is not currently represented on the CFR and this is appropriate as one of its tasks is to advise Government on the adequacy of Australia's financial regulatory arrangements. However, we submit that a body exercising the powers identified above should include not only a representative of each of the RBA (as chair), APRA and ASIC but also a Government representation, in the form of a Treasury representative with the same vote as each of the other members. We believe that Government representation is important given the nature of the powers. We do not believe that any other regulatory bodies would need to be members of a body exercising such powers.

We do however support the current regulatory coordination function of the CFR. We do not believe that a body performing this role necessarily needs to be established by statute. However, we strongly support coordination of regulatory endeavours between all regulators which an impact on the financial sector and its participants. We therefore believe that it would be appropriate to include it would be appropriate for the ACCC, AUSTRAC and ATO to be members of the CFR while it retains its current mandate.

Regulators

The Interim Report has sought submissions on the following matters:

- Alternative options for emphaising competition matters beyond amending mandates, eg by: 3-127
    - requiring the RBA to report every three years on the efficiency and competitiveness of the financial system;
    - appointing an additional APRA member or establishing another mechanism for considering the impacts of regulatory intervention on competition;
    - requiring APRA's annual report to include a section on competition.

Minter Ellison response

As indicated in our previous submission, we believe there is merit in requiring all regulators with responsibilities in the financial sector, including the RBA, APRA, ASIC and AUSTRAC (but not the Macroprudential Regulator we discuss on page 6), to:

- consider the effect of any regulation, policy or guideline they make on the basis of whether and how it promotes innovation, efficiency and competition in the sector.
- require regulators to submit regulatory material to an independent panel (with representatives from industry, government and consumers) to assess whether it meets one of two criteria:
    - the change promotes innovation, efficiency and competition; or
    - if the change is required to protect consumers, via a fair, orderly and transparent operation of financial markets or to reduce systemic risk, the change is implemented in a manner that promotes, or minimises the impact on, innovation, efficiency and competition.

Procedures could be implemented to ensure that such a process does not operate as a significant impediment to making required changes, including by permitting regulators to make urgent changes on an interim basis before panel approval is obtained and by setting time limits on the panel considering material.

Such a process would ensure that all regulators have the goal of promoting innovation, efficiency and competition front of mind and would therefore significantly enhance the focus on competition, innovation and efficiency by regulators.

We also strongly support:

- requiring the RBA report every three years on the efficiency and competitiveness of the financial system; and
- requiring the annual report of financial sector regulators, including APRA, to include a section on what they have done to report on the steps that they have take to promote innovation, efficiency and competition in the sector and to identify and justify any measures they have taken which may have impeded innovation, efficiency and competition.

- Refine the scope and breadth of ASIC's mandate, eg by: 3-124
    - moving responsibility for generic consumer regulation to the ACCC;
    - moving industry-specific consumer regulation to a new regulator or the ACCC;
    - splitting market supervision into a specialised regulator;
    - moving insolvency functions to the Australian Financial Security Authority;
    - moving the registry function out of ASIC;
    - increasing emphasis on oversight of self-regulating bodies.
- Are changes needed to strengthen and/or refocus ASIC? 3-129

Minter Ellison response

We do not support moving responsibility for consumer regulation in the financial sector to the ACCC for either generic or industry specific regulation. Financial services and products are very different to other types of consumer products designed for immediate use and typically without the same kind of long-term commitment and reliance that characterises financial services and products. We do not believe that there has been any evidence to suggest that the Wallis Inquiry conclusion that consumer protection is best regulated by a single financial sector regulator. The Explanatory Memorandum to the *Financial Sector Reform (Amendments and Transitional Provisions) Bill 1998* (**FSR 1998 EM**) which gave ASIC responsibility for consumer protection made the following observations:

3.15 The key possible advantages of combining regulatory arrangements for consumer protection across the whole financial sector would be:

- *greater consistency of regulation;*
- *minimisation of regulatory gaps or overlaps;*
- *reduced risk of regulatory capture; and*
- *the development of a stronger single body of expertise.*

3.16 The key possible disadvantages would be:

- *loss of specialisation and coordination with prudential regulation or other related areas of regulation in specific industry sectors;*
- *loss of competition between regulators;*
- *costs of transition.*

3.17 The FSI found the arguments in favour of amalgamation to be compelling. The existing system's negative consequences included substantially differing disclosure requirements for similar investment vehicles and inconsistency in approach to regulation of financial sales and advice. Although splitting the consumer protection function from other aspects of regulation (such as prudential supervision) means that some participants offering specific services would have to deal with two regulators when they previously dealt with only one which handled both functions, this disadvantage is outweighed by the advantage to participants offering a range of services who currently face a multitude of regulators which take different approaches to consumer protection issues.

3.18 Further, retention of institution-based regulators is unlikely to facilitate flexibility and responsiveness to the forces shaping financial markets, including new entrants to the industry, new products and means of service delivery which increasingly blur distinctions between products and institutions.

3.19 The FSI considered that better focused, more consistent and responsive regulation would be delivered by a single regulator performing the consumer protection function for banking services and comparable services offered by non-bank deposit-taking institutions, retirement savings accounts, superannuation, life insurance and general insurance. Other products and services with similar characteristics should also come within the ambit of the scheme. Accordingly, friendly societies should also be subject to the jurisdiction of the single regulator.

We consider that these conclusions remain true today, in particular the need for focussed, consistent and responsive regulation.

ASIC's mandate

We are concerned that the broad range of ASIC's responsibilities may make it difficult for ASIC to focus sufficiently on consumer regulation in the financial sector. We do however note the following observation in the FSR 1998 EM:

3.2 Market integrity regulation seeks to promote market development by securing confidence and protecting participants from fraud and other unfair practices. Consumer protection aims to ensure that retail investors have adequate information, are treated fairly and have adequate avenues for redress. Often it is difficult to distinguish between regulation directed at market integrity and consumer protection, since both use the regulatory tools of conduct and disclosure rules.

We support this conclusion and believe that ASIC should retain responsibility for regulation of market integrity, consumer protection and capital raising. However, there may be a case for ensuring that ASIC is focussed solely on the financial sector and that a separate regulator should have responsibility for economy-wide functions, such as general corporate regulation.

Prosecution

ASIC's limited resources need to be deployed as effectively as possible to maintain consumer confidence and trust in the financial sector. This requires ASIC to be a fearless regulator dealing with misconduct firmly and promptly. While this has occurred to some extent in capital markets, ASIC seems to have focussed more on administrative sanctions than prosecution when it comes to consumer protection regulation. Lengthy delays in taking action in some recent cases have also damaged ASIC's reputation. While it is important that ASIC does not prosecute without a good case to answer, it is also important for the criminal consequences of offences to be seen to be brought home for those who commit them.

Test cases

We also believe it is important for areas of regulatory uncertainty to be tested in court. Consideration should be given to how ASIC can be encouraged to take test cases to court where required to establish the correct legal principles to be applied by regulated entities. This should be done in a way that does not impugn the reputation of defendants in the absence of evidence of culpable conduct, ie where a regulated entity is reasonably relying on appropriate legal advice or established industry practice. It may be appropriate to establish a mechanism where such cases can be funded and for orders to be obtained to prohibit reporting the names of the defendant in this type of case.

Self-regulation

We believe that one way for ASIC to marshal its limited resources more effectively would be to rely more on oversight of self-regulating bodies and therefore not needing to regulate conduct directly. This has prove very successful in relation to consumer complaints bodies such as the Financial Ombudsman Service (FOS) and the Credit Ombudsman Service (COSL). We believe it that this approach could be extended to other areas of regulation such as the supervision of financial advisers (see our comments on approved professional bodies on page 23).

However, effective self-regulation requires ASIC to have the power to approve codes of conduct which deviate from legislated regulation to enable self-regulatory bodies to adjust regulatory requirements and outcomes suitable for their particular circumstances. We note that Part 7.12 of the Corporations Act gives ASIC the power to approve codes of conduct. However, we are not aware of any codes that have been approved under it. We believe this is because there is little point in obtaining ASIC approval as ASIC can only approve a code if it is satisfied that it is not inconsistent with the Corporations Act and it is consistent with other relevant codes where appropriate. Furthermore, ASIC has adopted a policy in Regulatory Guide 183 that it will only approve industry codes which among other things are broad ranging, set standards beyond legal requirements, and are not single-issue industry guidelines. We believe that ASIC needs to take a more flexible approach to code approval in future and should be mandated to encourage the development of codes of conduct where appropriate.

- Is the current enforcement regime adequate? Does ASIC have adequate powers? 3-129

Minter Ellison response

We believe that the current enforcement regime is generally appropriate and ASIC has the powers it needs to properly enforce the regime. The key question is whether ASIC has sufficient resources to engage in sufficient and appropriate enforcement activities and the approach it adopts in relation to enforcement.

Infringement notices

We have concerns regarding infringement notice regimes and do not support any extension of this type of regime in financial regulation. We believe that offences and breaches of civil penalty provisions are only effective as deterrents where prosecuted and an appropriate penalty is imposed. Infringement notices tend to reduce the significant of the matters to which they relate to the level of parking and minor traffic offences in the mind of the public and the regulated community. The cost of defending infringement notices means that they are not worth defending. Recipients therefore pay the fine whether or not they concede the breach has occurred which means infringement notices risk being seen as an arbitrary exercise of power, undermining confidence in the regulatory system.

- Review mechanisms to attract and retain staff, including terms and conditions and exempt APRA and ASIC from the public sector bargaining framework and, to the extent it applies, the Public Service Act 1999. 3-128

Minter Ellison response

We strongly endorse the Inquiry's observation that regulators need suitably skilled and experienced staff and believe that it is critical for financial sector regulators to have as much flexibility as possible in the means they can use to attract and retain the best staff available, including the ability to match private sector salaries, terms and conditions.

Other matters

We submit that the following issues should also be addressed in the Inquiry's final report.

Overlapping regulation and regulators

As noted on page 7 of our previous submission, there is considerable overlap between regulatory responsibilities and regimes in the financial sector. In the interests of efficiency, we submit the following changes should be made:

- There should be a single regulator for money-laundering, terrorism financing and customer identification. This could be AUSTRAC. This regulator should have responsibility for administration not only of the AML/CTF Act but also compliance with Australian sanctions regimes under the UN Charter Act and the Autonomous Sanctions Act and setting and ensuring compliance with tax identification requirements, such as FATCA and the proposed OECD equivalent (colloquially known as 'GATCA'). These roles may be on a delegated basis from current regulators, the Department of Foreign Affairs and Trade and the ATO respectively, but AUSTRAC (if it is the regulator) should have the ability to ensure that all of these regimes are applied and administered on a consistent basis in a manner .

- As privacy is a form of consumer protection, responsibility for administering the privacy regime in Australia could be given to the body with responsibility for consumer protection in the financial sector (currently ASIC). There would be a need for this body to work closely with the Office of the Australian Information Commissioner to ensure consistency in the application of the privacy regime across sectors of the economy.
- There should not be any requirement for prudentially-regulated bodies to hold an Australian financial services licence for activities which are subject to prudential regulation. Any relevant conduct-based obligations could be extended to apply to prudentially-regulated bodies where appropriate.

Form of regulation

We believe that the Inquiry should make recommendations concerning the overly complex nature of our regulatory regime, in particular the complex interaction between the provisions of Chapter 7 of the Corporations Act, overlapping provisions of the ASIC Act, exemptions and modifications in regulations and ASIC class orders, and ASIC's quasi-prudential and quasi-legislative guidance. This type of complex regulation impedes efficiency and regulatory certainty and reduces confidence in the regulatory system by both participants and consumers.

This problem is exacerbated by the difficulty of achieving carefully balanced and appropriate regulation on a timely basis through either Governmental or Parliamentary processes. We submit that Parliament and Government are well positioned to set the broad parameters and principles for the regulatory regime which should apply to the financial system but cannot realistically be expected to have the expertise or capacity to determine the appropriate application of such principles to specific sectors, activities or conduct within the system. Consideration needs to be given to giving rule-setting powers to an appropriate body to fill in the details required by industry within the broad-brush principles articulated by Parliament and Government. Appropriate consideration also needs to be given to key legal principles such as separation of powers and the rule of law when establishing this body: policy development and rule making needs to be kept separate from enforcement.

Regular reviews

We do not believe the response: 'if it ain't broke, don't fix it' is an appropriate response to the suggestion that the timing of reviews of the financial system should be made more regular and less reactive to external events. We acknowledge that regular reviews cannot prevent external shocks to the system or anticipate all of the impacts they may have or every instance of regulatory failure. Nevertheless, we believe that a well-run system will include a mechanism for regular review. We therefore submit that the Inquiry should recommend the establishment of a system of regular reviews of the financial system which should occur at least every 10 years.

Consultation

In 2007, the Council of Australian Governments adopted the Best Practice Regulation guidance which includes the following seven principles for best practice consultation (Appendix F):

- **Continuity** — Consultation should be a continuous process that starts early in the policy development process.
- **Targeting** — Consultation should be widely based to ensure it captures the diversity of stakeholders affected by the proposed changes. This includes Commonwealth, State, Territory and local governments, as appropriate.
- **Appropriate timeliness** — Consultation should start when policy objectives and options are being identified. Throughout the consultation process stakeholders should be given sufficient time to provide considered responses.
- **Accessibility** — Stakeholder groups should be informed of proposed consultation, and be provided with information about proposals, via a range of means appropriate to those groups.
- **Transparency** — Ministerial Councils need to explain clearly the objectives of the consultation process, the regulation policy framework within which consultations will take place and provide feedback on how they have taken consultation responses into consideration.
- **Consistency and flexibility** — Consistent consultation procedures can make it easier for stakeholders to participate. However, this must be balanced with the need for consultation arrangements to be designed to suit the circumstances of the particular proposal under consideration.
- **Evaluation and review** — Policy agencies should evaluate consultation processes and continue to examine ways of making them more effective.

These principles have been adopted by the Australian government,[1] but have singularly failed to be implemented when it comes to certain recent reforms affecting the financial system. In particular, consultation has frequently been undertaken on unreasonably short timeframes on a very limited basis without effective involvement of the regulated community and without therefore the ability to give properly considered responses. Admirable as COAG's principles are, they seem to be

[1] http://www.dpmc.gov.au/deregulation/obpr/consultations/index.cfm

honoured as a matter of convenience rather than on a consistent and reliable basis. We also believe that there is a missing eighth principle:

- **Engagement** — Policy agencies should give careful consideration to stakeholder submissions, paying particular heed to concerns regarding consistency with government policy, the practical effects of proposals and the consequences for consumer protection, efficiency, innovation and competition in the financial system. As part of the process, each separate issue identified in submissions with are not frivolous or vexatious should be identified and responded to having regarding to these consequences.

We note that these principles have not found there way into legislation. The closest we are aware of is s17 of the *Legislative Instruments Act* which provides that rule-makers must be satisfied that they have undertaken any consultation they consider to be appropriate and reasonably practicable. In forming this assessment, rule-makers **may** have regard to the extent to which the consultation draws on the knowledge of experts and whether affected persons had an adequate opportunity to comment. This obligation merely seems to require rule-makers to give consideration to whether to undertake consultation.

We submit that effective consultation on regulatory change is critical to the efficient operation of the financial system and therefore believe that the eight consultation principles referred to above should be made mandatory for rule-makers and government bodies.

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page reference

Appendix B: Regulatory Perimeter

Systemic risk

The Interim Report has sought submissions on the following matters: 3-28-30

- What is the most appropriate way to ensure that systemic risks outside the prudential perimeter can be managed?
- Establish a mechanism, such as designation by the relevant Minister on advice from the RBA or CFR, to adjust the prudential perimeter to apply heightened regulatory and supervisory intensity to institutions or activities that pose systemic risks.
- Is new legislation the most appropriate mechanism to adjust the prudential perimeter to respond to systemic risks, or could a more timely mechanism be of benefit? What alternative mechanisms could be used?
- What accountability processes would be necessary to accompany any new mechanism?

Minter Ellison response

As a general rule, we believe that legislation is the most appropriate mechanism to adjust the prudential perimeter. However, if there an economic shock or emergency, there may not be time to go through the process of passing appropriate legislation. The Macroprudential Regulator approach we have discussed on page 6 may be appropriate in such circumstances.

- Are there any specific macroprudential tools that Australia should adopt to manage systemic risk?
- What agency or agencies should have these macroprudential tools?

Minter Ellison response

Refer to our submissions on the CFR on page 6.

Conduct regulation

The Interim Report has sought submissions on the following matters: 3-108

- Require providers of fund administration and technology service of sufficient scale to be licensed, but clear risk-based criteria to identify appropriate entities without imposing undue burden on all service providers.

Minter Ellison response

Many fund administrators already have an Australian financial services licence authorising them to deal in financial products, including arranging for others to acquire and dispose of financial products. However, we acknowledge that there is no regulatory regime or licensing criteria specifically directed at fund administrators.

Technology providers are not necessarily required to hold an Australian financial services licence.

We are not convinced that a case has been made out for requiring specific licensing requirements to apply to these service providers. As the Inquiry acknowledges (page 3-106 - 7 of the Interim Report), significant administrators and technology providers will invariably be providing services to regulated entities and are therefore able to be regulated indirectly through these regulated entities, which in fact occurs particularly through APRA's Outsourcing Standard CPS 231. We submit that if any systemic risks arise in relation to such service providers, it should be dealt with by the Macroprudential Regulator we discuss on page 6 or by legislation.

- Apply market integrity rules for licensed securities dealers that provide investor services substantially similar to market participants of a licensed financial market to enable ASIC to use market integrity-specific remedies to address misconduct by securities dealers or their clients.

Minter Ellison response

We are concerned that the market integrity rules are designed for market participants and various aspects may not be appropriate for other security dealers. Any proposal to extend the reach of particular market integrity rules should only be undertaken after a careful assessment to ensure there are no unintended consequences.

- Introduce a mechanism to allow a heightened level of regulatory intensity to be applied where risk arises outside the conduct perimeter.

Minter Ellison response

As a general rule, we believe that legislation is the most appropriate mechanism to adjust the conduct perimeter. However, if an economic shock or emergency requires urgent adjustment of the conduct perimeter, then the Macroprudential Regulator we discuss on page 6 may be the appropriate body to make the decision in such circumstances.

Appendix C: Consumer Protection

Disclosure

The Interim Report has sought submissions on the following matters:

- Improve the current disclosure requirements using mechanisms to enhance consumer understanding, including layered disclosure, risk profile disclosure and online comparators. 3-62

Minter Ellison response

Product disclosure statements

We believe that the current disclosure regime for financial products has failed for two key reasons:

- As the Inquiry has recognised on page 3-55 of the Interim Report, disclosure plays an important role for different industry participants. This has meant that the product disclosure statement (PDS) has too many incompatible purposes and uses.
- The genesis of the PDS regime was a one-size-fits-all approach which inappropriately imposed the same disclosure requirements for investment and non-investment products. Significant modifications to the regime for different products means that is no longer so true but this has added complexity and compromise to the regime.

It is time to start again with a new set of principles leading to a new set of requirements (with appropriate transition periods to reduce the burden of change on industry):

1. The PDS regime should only apply to investment products, including superannuation. Different disclosure principles and requirements should apply to non-investment products, such as insurance, basic deposit products and non-cash payment facilities.

2. The information asymmetry between issuers and retail investors needs to be addressed by requiring issuers to provide access to the information that investors need to make an informed decision whether to make the investment. We submit that the PDS regime enacted in the original *Financial Services Reform Act 2001* remains the most suitable regime for investment products. Like the prospectus regime, the original PDS regime required issuers to focus on the information retail investors need to decide whether to make the investment.

   We believe that the failing of the PDS regime since its introduction has been a focus on trying to simplify the information presented in the PDS in a form that can be easily understood by any retail client. This approach produces generic disclosure that does not focus on the specific features and risks of the particular investment. The shorter PDS regime in Subdivisions 4.2-4.2C and Schedules 10B-10E of the Corporations Regulations is the culmination of this process producing documents that do not adequately describe the investment and need to be supplemented by a plethora of supporting material.

   We believe that the need for a single point of reference for the information about an investment offer is important for all types of investments: whether in the form of a prospectus for ASX-listed investments (see our comments below) or a PDS for other types of investment, such as managed investment schemes, superannuation, derivatives and foreign exchange contracts.

   This type of disclosure document will serve many of the uses identified by the Inquiry for disclosure: minimise information asymmetry for consumers by making detailed information available; helping intermediaries understand the detailed features of the product and to compare products; and defining the product for issuers (see page 3-55 of the Interim Report.

   We do not believe that the shorter PDS regime meets this test and therefore believe it should be repealed. Of course, this should be done with a suitable transition period which should allow issuers to continue to use existing shorter PDSs until a change occurs which requires them to be replaced.

3. There is no need for comprehensive disclosure such as a PDS to be given to investors before they invest, provided it is easily accessible. It may have been necessary in the past to require issuers to give the disclosure document to investors before the widespread availability of the internet but it is no longer necessary today.

4. Layered disclosure requires making the information an investor needs at the time they need it. We believe that this can be achieved by requiring certain key information to be made available to the investor when the investment is promoted and when it is applied for. In an internet environment, there is no need for all of this information to be displayed to the client where there is a readily identified link to the information. We therefore suggest the following would be appropriate for all types of investment and platforms such as investor-directed portfolio services (IDPS):

   a. Advertising the investment should only require the website address for the regulated disclosure document.

   b. Promoting the investment on the internet (for example on a webpage relating to the investment) should include clearly labelled links to the regulated disclosure document, fee information, risks and any conflict disclosures.

   c. These links should also be included in any electronic application form for the investment.

   d. If a paper application form is used, it should be required to be attached to a short statement which includes how to access the regulated disclosure document, (where appropriate) a fee table similar to the fee table used in shorter PDSs, any other key information about fees and costs, and key features, risks and conflict disclosures. The focus of the disclosure of these key features should be on anything that makes the investment different from other similar investments to assist product comparison. This information should be able to be no more than four A4 pages in length.

Insurance, basic deposit products, non-cash payment facilities and other non-investment products

We do not believe that a PDS is required for non-investment products. Instead, the terms and conditions need to be available to customers and prospective customers. The provision of these documents will be governed by relevant product-specific regulation: the Insurance Contracts Act for insurance products and the Code of Banking Practice and the Customer Owned Banking Code of Practice for deposit products. If any additional disclosure is required for these products, it should addressed in the relevant legislation or code.

Financial services guides and statements of advice

We also believe that there is too much emphasis on the form of disclosure when it comes to financial services guides and statements of advice. Each of these documents has some critical elements of mandatory disclosure, in particular conflicts and remuneration disclosure. However, we query whether this information needs to be given in a prescribed format. We believe that it should only be required to be given in a clear, concise and effective format before the client is contractually bound to acquire a product or service. It is not essential for some of the information to be given at this time if it is easily accessible to the client, for example on a service provider's website, for example contact details, authorised financial services and dispute resolution details.

Key facts documents

We do not support the extended application of key facts documents. In our experience, these documents are generally too prescriptive and risk misleading consumers through over-simplification or focussing on factors which are may not be the most relevant for a particular purchasing or investment decision. They inevitably face the round-peg, square-hole problem.

One of the reasons why such documents fail is that they are developed by regulators who do not have a good understanding of the products or their customers. In our view, if key facts documents are to be developed and mandated, they must be done so on a self-regulatory basis to maximise their usefulness for consumers. This may of course occur in accordance with broad principles set by of a regulator such as ASIC and with the involvement of consumer groups.

Online account portals

The recent reforms to the *Insurance Contracts Act* and the *Electronic Transactions Act* have codified the ability of insurers to provide notices and other communications to policyholders electronically. However, these regimes do not directly align with the electronic communications provisions within FSR and there is therefore a risk that the ability to provide notices under the *Insurance Contracts Act* does not permit insurers to deliver notices via online account portals similar to those used in banking. A recommendation to address this issue would be consistent with the Inquiry's focus on the use of technology to provide disclosure more effectively (page 3-59 of the Interim Report).

- Do similar issues in relation to the PDS disclosure regime apply to prospectuses, and is there a need to review prospectus requirements? 3-62

Minter Ellison response

In our experience, the prospectus regime for securities is working well generally and we do not believe that it needs to be reviewed. We are concerned that the more recently introduced requirement for a prospectus to be clear, concise and effective in s715A of the Corporations Act 2001 seems to be used by ASIC as a back door to impose a form of 'merit' based regulation of capital raising which we do not believe is appropriate.

We strongly believe that all ASX-listed investments, including trusts, should be subject to the same prospectus disclosure regime. There is no basis for treating investments listed on the ASX differently depending on the form of the vehicle.

We submit that disclosure principles 3 and 4 articulated above in relation to PDSs should also apply to prospectuses, with appropriate adjustment (eg a fee table is unlikely to be required).

Product suitability

The Interim Report has sought submissions on the following matters: 3-61-2

- Subject product issuers to a range of product design requirements, such as targeted regulation of product features and distribution requirements to promote provision of suitable products to consumers similar to MySuper and credit products.
- Impose positive obligations on product issuers with respect to the suitability of their products for retail clients. This could include requiring a product issuer to state the particular classes of consumers for whom the product is suitable or unsuitable and the potential risks of purchasing/investing in the product. Alternatively, the issuer could be required to determine that the product is suitable for a particular individual.
- Provide ASIC with additional powers such as:
    - Product intervention powers to prescribe marketing terminology for complex or more risky products.

   - A power to temporarily ban products where there is a significant likelihood of detriment to consumers.
- Consider a move towards more default products with simple features and fee structures.

Minter Ellison response

We are very concerned with any suggestion that the range of products made available to retail investors should be limited to simple products which are determined by the Government or ASIC to be suitable for retail investors. Such an approach would give rise to a significant moral hazard for the regulatory authority with responsibility for deciding the types of products which are suitable for retail investors. Such an authority must inevitably take a cautious and conservative approach to permitting products to be distributed to retail clients. Otherwise, they risk being seen to be responsible for permitting retail clients to invest in a product which subsequently fails. In our view, this approach will lead to a significant reduction in competition and innovation in the financial system.

One of the strengths of Australia's financial system is that there are no artificial barriers on the types of products available to the retail market. This has in turn led to the dynamic, innovative financial services market for which Australia has such a strong reputation. We believe that imposing artificial limits on the retail market will negatively affect the strength and competitiveness of the financial system, including ultimately the wholesale market, and therefore our ability to compete internationally.

We strongly support appropriate levels of conduct regulation in the retail market and recognise the important of maintaining consumer confidence in the financial system. Key elements of conduct regulation in the current system beyond disclosure (which is a critical component) include the regulation of personal advice under the Future of Financial Advice (FOFA) regime, prohibitions on misleading, deceptive conduct, unconscionable and dishonest conduct and hawking and client money restrictions and requirements in the ASIC and Corporations Acts. Additional obligations apply to:

- product issuers, including fiduciary and related obligations which apply to superannuation trustees and responsible entities of registered schemes and duties arising under the Insurance Contracts Act and the Life Insurance Act in relation to insurance products; and
- licensees, including obligations to ensure financial services are provided efficiently, honestly and fairly, to have arrangements to manage conflicts of interest, to have appropriate compliance and dispute resolution measures and to have adequate compensation arrangements.

We submit that current conduct regulation provides a significant degree of protection for retail clients and this is reflected in our reputation and record as a well-regulated financial services market. Of course, no system can prevent misconduct and effective enforcement is critical to maintaining a culture of putting client interests first.

We believe that it is important not to regulate to the lowest common denominator. There are a range of retail clients with differing and changing needs. We need a financial system which is capable of catering and adjusting to those needs. This will not be achieved by intrusive government regulation. Regulation, like all good things, needs to be moderate, measured and fit for purpose.

We acknowledge that product issuers have a responsibility to develop and maintain products that are suitable for the customers they are designed for. In the main, we believe that this responsibility is addressed through the well-tested and effective prohibition on misleading and deceptive conduct which prevents product issuers misleading customers regarding the purposes for which or the circumstances in which a product might be suitable. We do not believe that product issuers are generally well placed to determine whether their product is suitable for a particular client. Unlike the credit market where lenders require a significant amount of information about the borrower to determine whether to make a loan, issuers of other types of financial product do not generally need to obtain a significant amount of information about clients. They are not therefore well-placed to assess whether their products are suitable for clients without undertaking a detailed and intrusive assessment of their circumstances. We submit that this is the role of financial advisers and not product issuers.

We do not therefore believe that a product suitability obligation should be imposed on product issuers. We note however that the regime of consumer guarantees in Subdivision B of Part 3-2 of the Australian Consumer Law does not apply to financial services or products and there is no equivalent regime in the ASIC Act. It may be appropriate to review whether these guarantees should be included in the ASIC Act.

If any additional suitability obligation is imposed, it should be limited to simply requiring issuers to identify the types of clients for whom the product may be suitable when promoting the product. This should not need to be done in any kind of prescriptive format.

As noted above, we believe that that it is reasonable to expect product issuers to develop and maintain products that are 'fit for purpose'. However, restrictions on the ability of product issuers to adjust product terms and rationalise products makes this task very difficult and often impossible for product issuers, in particular in relation to legacy products. We therefore submit that any product suitability obligation should only be imposed on issuers once there is a robust and effective product rationalisation regime in place for managed investment and life insurance products.

ASIC powers

We are not opposed to providing ASIC with additional powers to ban certain terminology for complex or more risky products, provided the power is used sparingly and after appropriate consultation. We are more concerned about any proposal to enable ASIC to prescribe the terminology required to be used in relation to products or product features. We submit that ASIC should be focussed on addressing any instances of misleading descriptions of products rather than forcing the use of particular language.

We believe any power to temporarily ban products has the potential to create a moral hazard for ASIC as discussed above requiring ASIC to ban products rather than run the risk that a product which is not banned subsequently causes financial detriment to clients. Product banning should remain a matter for Parliament.

Other matters

The Interim Report has sought submissions on the following matters:

- Are there elements of the consumer framework not covered in Chapter 6 of the Report that require consideration? 3-87
- In addition to the current regulatory framework, what role can industry self-regulation play in improving consumer outcomes generally?

Minter Ellison response

Retail client test

We believe that the retail client test which determines the level and nature of regulation which applies to the provision of financial products and services needs to be reviewed and simplified. For example, consideration could be given to the following refinements:

- The application of the retail client test to superannuation is unduly complex. Consideration could be given to treating an individual's decision whether to invest in superannuation and choices within superannuation as always retail, including whether to establish a self-managed superannuation fund (SMSF). However, the test for financial services and products provided to superannuation trustees, including SMSF trustees, and to employers, including in relation to superannuation, should be based on the same test that applies to other financial services and products.
- Likewise, individuals receiving life insurance services and products should always be treated as retail clients. Other entities receiving life insurance services should be based on the same test that applies to other financial services and products.
- Community bodies and associations should always be treated as retail clients, unless they have gross assets of more than $100 million **and** the person authorised to make decisions on their behalf relating to financial services and products is certified to meet the sophisticated investor test in s761GA of the *Corporations Act*.
- The sophisticated investor test in s761GA should otherwise be restricted to investment products, such as securities and managed investment products.
- The employer test in s761G(7)(b) should not differentiate between manufacturing and non-manufacturing businesses. We submit that a 20 employee test is appropriate for all businesses. Furthermore, the employer test should be based on employees not only of the client but also its related bodies corporate. Service providers should be entitled to rely on a client's representation in this regard where the service provider is satisfied that the financial service or product is provided for use in connection with a business.

Appendix D: Banking

Capital requirements

The Interim Report has sought submissions on the following matters:

- Mainain the current callibration of Australia's prudential framework. 3-41
- Calibrate Australia’s prudential framework, in aggregate, to be more conservative than the global median. This does not mean that all individual aspects of the framework need to be more conservative. 3-41
- Is there any argument for calibrating Australia’s overall prudential framework to be less conservative than the global median? 3-41

Minter Ellison response

We agree that there is an argument in favour of calibrating Australia's prudential framework to be more conservative overall in that it would continue to signal good things to global investment markets. The perceived robustness of Australia's overall prudential framework relative to a number of OECD peer countries served Australia and its financial institutions accessing debt markets well in the aftermath of the GFC. It also enhanced the influence that our regulators have in recent years been able to enjoy on global standard setting bodies. Australia continues to be a capital importing country and aspires to be, through its main cities, a significant regional financial centre. Calibrating the overall prudential framework to be more conservative than the global median has not obviously disadvantaged (and may have advantaged) the competitiveness of notable global financial centres such as Singapore and Switzerland and would both be consistent with our country's history of and current approach to prudential regulation.

- Develop public reporting of regulator-endorsed internationally harmonised capital ratios with the specific objective of improving transparency. 3-42
- Adopt an approach to calculating prudential ratios with a minimum of national discretion and calibrate system safety through the setting of headline requirements. 3-42

Minter Ellison response

We agree with the Inquiry's observation that the social (as opposed to private) cost of higher equity funding may not be as much as presumed and note the work and observations of Adair Turner and the Bank of England's Andrew Haldane in making this point better known.

Too big to fail

The Interim Report has sought submissions on the following matters:

- Is it possible to reduce the perceptions of an implicit guarantee for systemic financial institutions by imposing losses on particular classes of creditors during a crisis, without causing greater systemic disruption? If so, what types of creditors are most likely to be able to bear losses? 3-12

Minter Ellison response

We support the notion of imposing (with suitable transition timing but at meaningful levels) minimum 'gone-concern loss-absorbing capacity’ (**GLAC**) layers on the capital structures of systemically important financial institutions (**SIFIs**). We believe it is, not least because of the rigour and ongoing monitoring that are likely to be imposed by investors in a SIFI's GLAC liabilities, one of the potentially most potent measures of the many measures needed to minimise the Too Big to Fail (**TBTF**) dilemma and associated moral hazard. Ideally, GLAC liabilities should be – without necessarily limiting the prudential regulator's ultimate resolution powers - limited to those that are explicitly marketed as and invested in as GLAC, rather than other categories of liability.

- Is there a case for introducing ring-fencing in Australia now or in the future? 3-20

Minter Ellison response

We appreciate that this is a costly measure and therefore should not be recommended without a thorough cost-benefit analysis. We believe there is a case for ring-fencing SIFIs (as one of a basket of measures) where the test suggested by the Swiss Commission of Experts Report of September 2010 (into the TBTF problem) (**Swiss TBTF Report**) is made out. That is, where the SIFI's activities include (a) services that are essential to the economy; and (b) other market participants cannot replace these services within a period of time that is tolerable for the economy. It is those activities and their necessarily related business infrastructure that should be ring-fenced.

- If pursued, what elements should be protected and from what risks? For example, should deposit-taking functions be protected from proprietary trading. Is one of the models used overseas appropriate for Australia? 3-20

Minter Ellison response

The Swiss TBTF Report referred to above and the UK's Vickers Report identify for those countries the elements that should be protected and can be studied for analogous elements in our SIFIs' activities.

- How 'high' should any ring-fence be? Do ring-fenced activities need to occur in entirely separate financial institutions, or could they be part of a group structure that has other business activities? Within a group, what level of separation would be necessary? 3-20

Minter Ellison response

The Vickers Report represents an attempt to find a balanced position on this question and should be carefully considered for its applicability here.

As to how high, there is little point in embarking on ring-fencing unless it is rigorous and likely to be enforced and effective over an extended time. A part of its being effective would be for it regularly to be re-assessed. As a result of the contestability of some services (for example, some elements of payment systems) and the impact of new entrants, it is quite possible that a SIFI's activities which previously met the essential and not within a tolerable time replaceable test mentioned above will cease to be so, in which case they might not need to be ring-fenced any longer.

- Are there ways to achieve the same benefits as ring-fencing without the costs of structural separation? 3-20

Minter Ellison response

There are ways, including close and effective supervision, and doing the 'living will' exercise and other rapid response resolution scenario planning regularly and effectively (which in itself will not be costless) to achieve some of the same benefits. These of course do not have to be alternative (as opposed to additional) measures to ring-fencing. We query, however, whether other alternative measures will be as transparent, or as likely to retain their effect over time.

- Increase the ability to impose losses on creditors of a financial institution in the event of its failure, including through bail-in mechanisms. 3-12
- Strengthen regulators' resolution powers for financial institutions, as proposed by previous Government. 3-13
- Invest more in pre-planning and pre-positioning for financial failure. 3-14
- Further increase requirements for systemically important financial institutions, including higher capital requirements and stronger risk management and stress testing requirements. 3-16
- Ring-fence critical bank functions, such as retail activities. 3-20
- Australian regulators make greater use of stress testing with appropriate resourcing. 3-31
- Mandating structural changes for individual banks or banning certain activities considered to be high risk 3-10

Minter Ellison response

A basket of measures is required because the TBTF and associated moral hazard issue is thorny. However, the basket should not encompass every possible measure.

Some of the measures referred to above will help to address (at least indirectly) the problem of pro-cyclicality but it is not clear that they will be enough. As we mentioned in our initial submission, there are numerous dimensions to pro-cyclicality. One example is the reality of the CEO's (or asset manager's) dilemma during times of boom of being expected by his or her board or investors to deliver returns as good as the peer group where the higher returns (on equity) might be (or it is uncertain whether the higher returns are) inflated. That is, the higher returns may arise, as they in many cases did in the period prior to the GFC, not by superior underlying business performance but by increased or hidden leverage, or by inadequately priced or ignored or hidden risk. Sustained prudent behaviour during booms will often result in the CEO or asset manager if perceived as too cautious being eventually replaced. It is also difficult for supervisors for sustained periods (even if not subject to regulatory capture) to lean against structurally flawed expectations of management and investors (who, overseeing or invested in a SIFI, may economically rationally be responding to an asymmetrical risk profile).

Other matters

Encouraging rational business structures

We have a preference that the Inquiry recommend, where possible, measures that encourage shareholders of SIFIs themselves (and genuinely at risk debt providers) to vote for or promote where appropriate more rational (from their but also from a systemic point of view), streamlined or separated business agglomerations. An example of such measures appears to be the reforms (including additional, graduated capital requirements calibrated to market share above 10%, total assets beyond a threshold and exposure to other systemically significant institutions) introduced in Switzerland in 2010/2011 in respect of Switzerland's SIFI's: UBS and Credit Suisse.

Implicit government subsidy

While we appreciate that there are complexities in estimating the implicit government subsidy that appears to accompany being TBTF, we believe that there are benefits to policymakers and regulators in a rigorous, objective, unconflicted and transparent (publicly available) assessment, repeated reasonably regularly and taking into account the positive effect (one hopes) of other reform measures implemented in the interim, of the following:

- the extent, if any, to which individual SIFIs engaged in maturity transformation, regardless of their form, enjoy an implicit government subsidy, in reduced funding costs or otherwise, by being perceived to be TBTF; and

- the extent (taking into account evolving business models and market developments), if any, beyond which there are no demonstrable current or reasonably foreseeable economies of scale or scope from particular types of banking or financial services business housed within large SIFIs.

Appendix E: Funding

Dividend imputation

The Interim Report has made the following observations: 2-58 - 9

- Dividend imputation reduces cost of equity and therefore contributes to lower corporate debt levels which in turn makes the corporate sector more resilient to shocks.
- However, if global markets set the cost of funding then dividend imputation acts as subsidy to domestic equity holders and may lead to increased investment in domestic equities, affect depth and liquidity of corporate bond market and reduce demand for annuities.

Minter Ellison response

While dividend imputation is attractive to domestic investors particularly superannuation funds, the different risk profiles of equity and corporate bonds (for example) mean that it is unlikely that there is a direct relationship between the choice to invest one over the other. In relation to the demand for annuities, this is more complex but we agree that a chronic shortage of long assets to support the liabilities is a factor but we do not believe there is a direct correlation with dividend imputation.

Australia's Future Tax System Review (the Henry Review) argued that the benefits of dividend imputation, particularly in lowering the cost of capital, have declined as Australia's economy has become more open. However, the Henry Review also acknowledged that the integrity benefits of imputation include:

- compensating Australian shareholders for Australia's relatively high rate of company tax;
- encouraging companies to set up in and retain profits in Australia;
- discouraging companies to shift profits and/or residency offshore; and
- fewer anti-avoidance rules (simpler taxation)

Dividend imputation is fundamentally a model of company and shareholder integrated taxation. Other considerations (in addition to bond market implications) will be relevant to any internationally competitive model of integrated taxation, including:

- the possibility of lower rates of taxation for dividends; and
- the introduction of deductions for equity funding.

Although the benefits and role of dividend imputation should be reconsidered given global developments since its introduction (in 1987) and the opportunity for simpler taxation, dividend imputation should be considered in the context of these broader tax policy considerations. We therefore agree that any final recommendations on these and other tax issues (with certain exceptions) should be considered as part of the Tax White Paper – which is due to complete in 2015.

SME access to funding

The Interim Report has sought submissions on the following matters:

- To what degree will technological developments resolve issues related to information asymmetries in SME lending? 2-68
- What are the best options to narrow the informational gaps between lenders and SME borrowers?

Minter Ellison response

We are not convinced that the funding costs of SMEs are largely attributable to information asymmetry. A large portion of the difference in margin is likely to be associated with the risk of not being able to predict the future success of the business. Smaller businesses are less resilient to shocks and for start-up businesses there is only limited information able to be shared in the first place. Reducing information asymmetries may not therefore necessarily have a material impact on SME pricing.

- Could the use of certain loan covenants be reduced, while still providing SMEs with adequate access to finance and lenders with appropriate protection?

Minter Ellison response

We understand that consideration is being given to whether to extend the unfair contract terms regime to contracts with small businesses at the moment. We submit that that process should be allowed to run its course.

We are however concerned about the potential impact that removing some covenants like non-monetary defaults might have on access to credit. The inclusions of non-monetary defaults may be the only basis on which a bank's credit department will agree to provide funding.

- What are the best options for improving the tax treatment of venture capital limited partnerships (VCLPs)?

Minter Ellison response

The Board of Taxation (after community and industry consultation) has completed a report which provides a comprehensive analysis of the tax reforms required for VCLPs. The recommendations were endorsed by the previous Government. The recommendations of this report should be adopted.

- Make comprehensive credit reporting (CCR) mandatory, add new fields and/or extend it to SME lending to more accurately assess credit-worthiness. 2-18

Minter Ellison response

It may be premature to assess the success of the voluntary CCR arrangements that came into effect on 12 March 2014. The new credit reporting regime involves enhanced compliance obligations and we understand the move to CCR will for larger organisation require significant changes to business and IT systems that take time to implement. It is possible that the failure of some organisations to adopt CCR to date may be a result of the cost and time that it is taking to implement fundamental changes to credit reporting practices. The implementation of the new credit reporting provisions involved the development of a new mandatory Credit Reporting Code, the terms of which were not finalised until shortly before the commencement date of 12 March 2014 and this may have impacted on the ability of many credit providers to participate in CCR.

In any event, any decision to implement CCR should consider the cost to industry and to consumers and the time necessary for adequate compliance measures to be put in place.

If any decision to move to mandatory CCR is made, then we consider that it would be important to ensure that an adequate transitional period (as determined by consultation with industry) is allowed for *after the finalisation of any changes to the formal legislative and Credit Reporting Code requirements* so that organisations can bring their business and IT systems into compliance with any additional compliance.

- Extend credit reform and unfair contracts terms regime to SME lending. 3-83

Minter Ellison response

We are inclined to agree with the comment in the Interim Report that regulating business credit more intensely may reduce access to or the affordability of credit for small business. A proposal to extend consumer credit reform to include business lending should be carefully assessed against these potential impacts.

The regulation of consumer credit (even as expanded to include investment in residential property) occurs within a relatively limited class of standard loan products and usually with relatively consistent underlying financial goals and objectives. Lending to small business requires significant flexibility. It needs to be able to allow for a wider variety of lending structures and products. The underlying commercial goals and objectives are also more diverse than for consumer lending. In our view, this makes the application of the consumer protection provisions to business lending difficult.

In previous options considered for Credit Reform Phase 2 there were varying models for extending consumer protections to small business lending. Some of the suggested models included a more comprehensive adoption of the more detailed consumer credit protection provisions to small business. We are not supportive of such an approach. To the extent that there is a view that regulation is required in small business lending, our view is that a lighter touch is required to avoid the potential risks of increased costs and reduced access. If there are particularly egregious practices in the market place, any regulatory response should be directed to those practices without unnecessarily importing provisions that carry with them high compliance costs.

Microfinance

The Interim Report has sought submissions on the following matters: 3-82

- Is there a role for Government and/or industry to facilitate further development of microfinance initiatives, in collaboration with the not-for-profit and community sector? To what extent would this improve access to small amount credit?

Minter Ellison response

We agree that there is a role for Government and/or industry to facilitate the development of microfinance initiatives in collaboration with the not-for profit and community sector.

One area where the Government may be able to assist is in the area of regulation.

Micro-financiers face significant regulatory burdens to establish and maintain their lending programs. These burdens may act as a significant disincentive for micro-financing projects and may deter participation by the not-for-profit and community sectors. It should also be born in mind that penalties for non-compliance in these areas is significant.

Even where regulatory burdens do not prevent entry into the sector they may divert limited resources towards compliance obligations (the cost of which may be disproportionate with the risk being addressed by the relevant legislation).

Minter Ellison would support a role for Government in helping to streamline the compliance burden for micro-financiers within the not-for-profit and community sector. Areas where micro-financiers may benefit from streamlined compliance obligations might include obligations under the *Anti-Money Laundering and Counter Terrorism Finance Act* and the *National Consumer Credit Protection Act*. Government could explore the extent to which it might exempt micro-financiers from some of the more onerous obligations under the legislation and/or provide streamlined/abbreviated compliance modules or disclosure modules which could represent 'safe harbour' compliance measures for such organisations. Such options should be considered as alternatives to and not as adding to existing compliance obligations for micro-financiers.

We suggest that streamlined compliance could be justified given the relative simplicity of most micro-financing products.

Separate recognition of the different role of micro-financiers within the *National Consumer Credit Protection Act* should also be considered (where micro-financiers may currently find themselves within the same regulatory category and subject to the same rules as other commercially based small amount lenders such as pay-day lenders).

The Interim Report discussion on micro-financing options refers to microfinance as being a way to improve access to credit for low income 'consumers'. While we suspect that the language of the Interim Report may not necessarily be intended to exclude micro-finance lending for business lending from the analysis, it is worth noting that micro-financing is traditionally used to support the development of small-businesses. In this respect micro-finance might be thought of not just an opportunity to allow consumers to develop positive finance habits, but also as a way for the development of positive business skills, as a bridge to assist financially excluded individuals to cross into a mainstream lending and as means of increasing self-sufficiency amongst those who might not otherwise have that opportunity.

Appendix F: Financial Advice

Quality of advice

The Interim Report has sought submissions on the following matters: 3-69

- Raise minimum education and competency standards for personal advice (including particular standards for more complex products or structures such as SMSFs), and introduce a national examination for financial advisers providing personal advice.

Minter Ellison response

We support raising education and competency standards for investment advisers. However, we believe that this may be best achieved through approved professional bodies. We do not believe that it is an effective use of limited regulatory resources for ASIC to have direct responsibilities for setting or administering education and competency standards for advisers. We believe that this is an area where self-regulation works best and oversight of such bodies is a much more effective way for ASIC to regulate in this area.

Advisers should be required to be a member of an approved professional body which should meet the normal standards for a professional body, including enforceable standards of conduct, the power to take action against members who breach the standard, including the power to terminate membership and to notify ASIC and other professional bodies.

It should be up to the professional bodies to determine whether to cooperate to establish a single national examination or whether to set their own form of assessment. We are concerned that a single national examination may not be the best method for continuing to improve adviser qualifications but may instead simply become the new minimum standard toward which all adviser training and education drives.

Approaches which we believe that professional bodies should consider include:

- requiring advisers to work under the supervision of a qualified adviser with a minimum period of experience in the relevant field before being able to practice in that field on an unsupervised basis; and
- establishing areas of competence and specialisation and requiring advisers to have qualifications and experience in those areas before giving advice on them.

Any change to adviser standards also needs to be done on a gradual basis to enable existing advisers to have time to demonstrate they satisfy the new standard without risking a significant reduction in adviser numbers.

However, we believe that current standards are broadly appropriate for Tier 2 products, eg most general insurance products and basic banking products.

- Introduce an enhanced public register of financial advisers (including employees) which includes a record of each adviser's credentials.

Minter Ellison response

Again, we believe that this task would be best undertaken by approved professional bodies. We acknowledge that a single national register would be needed but submit that this could be best and most efficiently administered by the professional bodies themselves. The professional bodies should determine what information should be included on the register in consultation with ASIC. This is likely to result in a more accessible register with greater flexibility to respond to consumer need.

- Enhance ASIC's power to ban individuals from management.

Minter Ellison response

We support the proposal for ASIC to have the power to ban the following from being a director, officer, or involved in the management of a financial services business:

- a representative of a licensee who commits a serious breach of the financial services laws which has the potential to cause significant loss to or significantly increase the risk of retail clients or who has repeatedly breached financial services laws;
- a person who is involved in the management of a financial services business and who is responsible for or wilfully blind to business practices which wilfully or recklessly breach financial services laws.

Accessibility of financial advice

The Interim Report has sought submissions on the following matters: 3-72

- What opportunities exist for enhancing consumer access to low-cost, effective advice?
- What opportunities are there for using technology to deliver advice services and what are the regulatory impediments, if any, to those being realised?
- What are the potential costs or risks of this form of financial advice, and what measures could be taken to mitigate any risks?

Minter Ellison response

Scaled advice

We believe more can be done to encourage the provision of scaled advice. While the recent FOFA Streamlining Regulations acknowledge that a client and adviser can agree on the subject matter of advice to be provided by the adviser. This is proposed to be addressed in the FOFA Streamlining Bill. However, the extent and nature of an adviser's duty when the subject matter is agreed are not made explicit. Scaled advice is a key means of making advice more accessible in terms of costs, time and the means by which it is delivered (whether in person, over the phone or via the internet). We therefore believe that greater regulatory certainty for this type of advice would be in the interests of clients and advisers.

Online risk profile disclosure and calculators

There is no doubt great potential for online tools to enable consumers to obtain a great deal of useful information that is tailored to them. While ASIC has issued a class order in relation to calculators, the conditions mean that very few providers can rely on it even for simple calculators that do not contain financial product advice or only general advice. More sophisticated online tools could be used to provide very tailored information and use information to consumers, but the restrictions on providing personal advice make it impractical to make them available in Australia.

Greater access to affordable financial product advice could be facilitated by making these kinds of tools easier to distribute. Amending or removing the statement of advice requirements in the manner suggested above would assist.

Distinguishing between independent and aligned advisers

The Interim Report has sought submissions on the following matters: 3-73

- Is there a case to more clearly distinguish between independent and aligned advisers, and what options exist for doing this?

Minter Ellison response

We believe the current restriction on the use of the term 'independent' is the appropriate way to manage the risk that consumers will misunderstand the independence of advisers from influences related to associations with product issuers. There is scope for additional words to be prescribed in the regulations if there is evidence that other descriptions used by advisers are misleading consumers, although we are not aware of any allegations to that effect.

We do not believe an approach similar to the UK, where aligned advisers are labelled as 'restricted advisers', is appropriate in Australia. We are concerned about the circumstances in which it may be used. Almost all advisers in Australia are 'restricted' in that they are only authorised to advise on certain types of products and within that range only products on their approved product list (APL). Furthermore, the recent introduction of the FOFA regime has introduced a new obligation for advisers to place client interests ahead of those of the adviser, their licensee and their associates (s961J of the *Corporations Act*). In that sense, no adviser in Australia is permitted to be 'restricted'. Any criteria for determining whether an adviser is 'restricted' is likely to be highly arbitrary, whether it is by reference to number of products or number of product issuers.

As discussed on page 14 above, we believe that the best way to address the concern regarding adviser associations with product issuers is to require this disclosure to be given to clients in a clear, concise and effective manner but not relying on it being disclosed in a prescribed document such as the financial services guide or statement of advice where the disclosure may be overwhelmed by other information.

General advice

The Interim Report has sought submissions on the following matters: 3-74

- Rename general advice as 'sales' or 'product information' and mandate that the term 'advice' can only be used in relation to personal advice.

Minter Ellison response

We agree that it would not generally be appropriate to promote general advice as 'advice' in that sense. This is could well breach the prohibition on misleading and deceptive conduct depending on the context in which it occurs. In our experience, however, it would be very unusual for general advice to be promoted in this manner. In circumstances where general advice is given, the provider is normally very concerned to ensure that they do not cross the line into giving personal advice with all the regulatory implications that has. The term 'advice' is therefore rarely used in this context, apart from the general advice warning which requires the provider to state:

> *This **advice** is general, it may not be right for you;*
>
> *This **advice** is not tailored, so you can't assume it will be suitable for you;*
>
> *This **advice** may not be suitable for you because it is general advice; or*
>
> *You will need to decide whether this **advice** meets your needs because I haven't.* (emphasis added)

These examples of simplified general advice warnings are from ASIC IR 05-62.

In fact, if consumers believe they are receiving 'advice', there is a risk that the advice given will be personal advice if it means that a reasonable person might expect the adviser to have considered one of more of the consumer's personal circumstances (definition of 'personal advice' in s766B(3) of the *Corporations Act)*.

We do not therefore believe that there is a significant problem which would require general advice to be renamed. We note that this is a term used in the *Corporations Act* solely for the purpose of differentiating general advice from personal advice and imposing different obligations on each. We are not aware of any suggestion that different consequences should apply to giving general advice than currently apply. Consequently, we do not believe any change is warranted.

Furthermore, we are concerned that the proposed names of 'sales' or 'product information' are themselves inappropriate. General advice is not only given in sales situations. It may for example be given by investment specialists in seminars or publications when discussing market activity and prospects. It is not limited to product information for the same reason. Furthermore, 'product information' suggests factual information about a product which is not currently regulated and which we do not believe needs to be regulated beyond ensuring it is not misleading or deceptive. Factual information is not a licensed activity and we do not believe it needs to be. It will therefore be confusing to rename general advice as 'product information'. It would suggest that this type of activity does not require a licence.

Other matters

Professional associations

We note that the Interim Report does not mention of requiring advisers to be a member of an approved professional association. For the reasons discussed on page 23 above, we believe that there would be merit in imposing such a requirement on investment advisers. We note that the role of an approved professional association or body would not be limited to setting education or competency requirements but sould extend to setting the standards of conduct expected of advisers. We believe that the establishment of professional bodies is crucial step in the development of a profession and in the maintenance of professional standards. It reflects the strong interest that the profession and all its members have in protecting the good name of the profession.

Appendix G: Financial Markets

Prospectus reform

The Interim Report has sought submissions on the following matters: 2-91, 2-94

- Raise $2m threshold for '20 in 12' prospectus exemption.
- Increase number of investors that can invest under the '20 in 12' prospectus exemption.
- Increase $10m threshold for offer information statements.
- Allow listed issuers (already subject to continuous disclosure requirements) to issue 'vanilla' bonds directly to retail investors without a prospectus.

Minter Ellison response

We support consideration of an increase to the limits for the prospectus exemptions. In relation to the number of investors for the '20 in 12' prospectus exemption, we submit that a more appropriate number may be 50 as this aligns to the proprietary company test (s113) and the application of the takeover provisions to unlisted companies (s606).

However, there are other problems caused by the prospectus exemptions. In particular, both the $2 million threshold for the '20 in 12' prospectus exemption and the $500,000 threshold related to the amount of funds raised. The tests are not value based and do not appear to apply where shares are exchanged for shares in the new company or in a corporate reconstruction. This contrasts with the test applying to the retail client test for other financial products in s761(7)(a).

Greater clarity and flexibility is also required to facilitate greater employee investment without infringing the limits of the prospectus exemption, including through self-managed superannuation funds.

We note that offer information statements are rarely used. In part, this is because of the low threshold and we agree that consideration could be given to increasing it to say $20 million or $50 million to enable a reasonably serious amount of seed capital to be raised. However, another reason why this option is rarely used is that ASIC takes a restrictive view on its availability, in particular in relation to compliance with financial requirements and is unwilling to grant relief to facilitate the use of this option. Greater flexibility by ASIC and a clear direction about its role to facilitate capital raising for smaller companies would be useful. Consideration should also be given to permitting offer information statements to be used for listings.

We support allowing listed issuers to issue 'vanilla' bonds directly to retail investors without a prospectus. Although this is unlikely to have a significant impact on the retail bond market in the short-term given the low cost of bank debt, it may play an important role when financial markets normalise.

Mid-caps

The Interim Report has sought submissions on the following matters: 2-94

- Is there a need to introduce differentiated markets, similar to LSE recent creation of a market segment for high-growth companies, to allow greater access to equity markets by smaller companies?

Minter Ellison response

Financial markets require liquidity and depth to be successful. We are not convinced that Australia can afford the luxury of multiple markets. It may be more useful to focus on how ASX listing requirements can be streamlined to facilitate greater access to equity capital.

Access for retail investors

The Interim Report has sought submissions on the following matters: 2-93 - 94

- Should other capital-raising requirements be modified to reduce dilution effects? Would this affect the capacity of corporates to raise funds, particularly under conditions of market stress?
- Requiring all existing investors be invited to participate in any on-market equity issue of continuously disclosing securities.
- Requiring all issues of new equity be conducted fairly, transparently and efficiently, unless shareholders approve the issue.

Minter Ellison response

We are concerned about the implications of imposing requirements to address dilution concerns for retail investors. We believe that any such measures are likely to have a significantly detrimental effect on the ability of companies to raise capital on an urgent basis dictated by market conditions. Any mandatory obligation is likely to require a raft of exemptions which will be complex to administer and comply with. It should be sufficient to rely on boards to comply with their general duties to shareholders and to have to bear opprobrium of shareholders if they act in a manner contrary to their interests.

We are also concerned that adding new duties to capital raising activities is unlikely to create uncertainty and deal risk impeding efficient capital markets.

Appendix H: Insurance

Aggregators

The Interim Report has sought submissions on the following matters: 2-41

- Enable aggregators to use automated processes to seek quotes from general insurance websites, recognising that this could enable aggregators to discover insurer's pricing models.
- Create comparison categories for insurance products so that aggregators could use insurers' disclosed premiums for each category to compare the value of different products

Minter Ellison response

Comparison websites can provide a useful service for consumers. However, we are concerned that that insurance products with differing features cannot be easily compared and there is a real risk for consumers who only compare based on price. We do not believe that proposals to create consumer and product categories will address this risk sufficiently and may lead to consumers failing to give proper consideration to their own needs and the different features of the products.

The United Kingdom Financial Conduct Authority's recent report on *Price comparison websites in the general insurance sector* (TR14/11) notes that an emphasis on price with insufficient information about features led consumers to assume that there were no significant differences between products. This in turn has led to insurance companies removing features to remain competitive.

We are also concerned with the public policy implications of any proposal to require companies to provide data or access to pricing to unrelated third parties. Such information is proprietary information with significant value and therefore by extension their competitors who may be able to gain a competitive advantage if the can obtain access to such information. It would be difficult to ensure that such information does not become more generally available if required to be disclosed to third parties.

We believe that it would not be appropriate for regulation to intervene in this area which should be left to the relevant parties to negotiate appropriate commercial arrangements.

Statutory insurance schemes

The Interim Report has sought submissions on the following matters: 2-41

- Open up state- and territory-based statutory insurance schemes to private sector competition.

Minter Ellison response

We welcome this proposal as a means of ensuring economically efficient use of resources for the provision of insurance services across all sectors of the economy.

Other matters

Disability insurance

The life insurance industry has been significantly challenged recently by the growing incidence of disability claims, particularly in relation to insurance provided through superannuation. This issue is important to the sustainability of the life insurance industry and its ability to provide disability cover to the general community, particularly through superannuation which is the means through which most Australians obtain this cover. This means that it is in turn an important social issue as any reduction in disability cover is likely to lead to increased demand for Government support through the welfare system. Furthermore, it is in the public interest to not only maintain but to increase levels of private disability cover with a view to reducing welfare costs to the taxpayer.

In our view, the Inquiry should consider the current issues relating to disability insurance and how levels of cover can be sustainably increased.

The current difficulties facing life insurance companies is caused by a number of factors including the application of the statute of limitations and the approach of the courts to generally used definitions. While APRA has recognised this problem and undertaken consultation recently in relation to proposed LPG 270 *Group Insurance Arrangements* which provides good practice guidance on risk identification, tendering and data management. However, we believe that changes to the life insurance or superannuation regulatory regimes also need to be considered, in particular:

- enabling life companies to require disability claims to be made within a specified period after the claim event occurs; and
- removing the restriction on the types of life insurance that can be offered through superannuation.

We also believe that the Inquiry should consider the report by Deloitte Access Economics on *Expanding the coverage of private disability insurance to reduce the economic burden of social disability insurance* commissioned by the Financial Services Council and published in March 2014 (http://fsc.org.au/downloads/file/policy/FSC-Privatedisabilityinsurancefinalreport.pdf). This report considers how disability insurance could help reduce the burden on the public purse by encouraging private cover to be obtained rather than relying on the National Disability Insurance Scheme (NDIS).

Health insurance

At present there are significantly different regulatory frameworks (and governing acts) between life, general and private health insurance companies. In particular, private health insurers are regulated by the Private Health Insurance Administration Council (PHIAC) rather APRA and ASIC. Given PHIAC performs similar roles, the Committee could consider stream-lining prudential and financial conduct regulation by integrating regulatory responsibility for private health insurance into the two main insurance regulators.

We also believe that some of the artificial distinctions between health insurance, life insurance and general insurance should be re-examined and removed. We believe that this could have significant benefits for simplifying regulation and reducing compliance costs as well as increasing competition and enabling insurers to provide the benefits to clients relevant to the cover provided. For example, restrictions on the ability of life companies to reimburse health related expenses reduces the ability of life companies to meet the costs of returning to work and therefore increases the costs to the community.

Taxes and stamp duties

We acknowledge that the Inquiry's terms of reference only contemplate the Inquiry making observations in relation to tax. However, we believe that Inquiry should be making observations on the issue of state and territory taxes and duties on insurance. State imposts on insurance raise two important concerns. First, while State taxes are not always directly passed on to consumers, they comprise part of the costs of providing insurance that are ultimately paid by the insured. This is relevant to the Inquiry's focus on consumer outcomes and the consideration of measures to address insurance affordability. Second, the inefficient State imposts on insurance impose a significant administrative burden on insurers. Again, these administrative costs impact the affordability of insurance for many Australians.

Group insurance licensing

The uncertainty in relation to the licensing position for the policyholders of commercial group insurance arrangements is an area where clarification through regulatory reform would be welcomed by the insurance industry. ASIC relief and associated guidance is useful in this area. However, we believe that a firmer policy direction is required in relation to when group purchasing bodies should require a licence. This will give certainty – and thereby increase availability of cover and potentially reduce un- and underinsurance – for insurers, intermediaries that establish such schemes, the group purchasing bodies which seek to provide cover to their members. ASIC has indicated for several years that further consideration will be undertaken by Treasury and ASIC in relation to addressing group purchasing bodies through regulations.

Appendix I: Managed Investments

Regulatory framework

The Interim Report has sought submissions on the following matters: 3-84

- Amend the existing regulatory framework for managed investment schemes, eg:
  - Change the 'trustee like' obligations of responsible entities (**REs**), for example by making the scheme a separate legal entity with the RE as its agent.
  - Review the structural requirements of MISs, including relevant definitions, the registration requirement, governance requirements, whether there should be investment guidelines, requirements for constitutions, RE duties and entitlements, conflicts of interest, change of RE, licensing custodians, meeting requirements.
  - Prohibition of the creation of new common enterprise schemes.
  - Clarify the definition of what can be called a liquid asset.
  - Clarify what is meant by 'scheme property' and how the client money provisions are applied to monies held by responsible entities.
  - Improve the external administration framework for failed MISs, so that it is comparable to the winding up of an insolvent company.

Minter Ellison response

While the thorough and careful consideration that CAMAC gave to the regulatory framework for managed investment schemes (**MIS**) is to be welcomed, caution needs to be exercised in deciding whether to implement CAMAC's recommendations.

We note that a key principle underlying CAMAC's views was that the regulatory regime for managed investment schemes should be aligned with that for companies. However, it is unclear to us why the regulatory regime for companies is preferable to the regulatory regime for MIS. A scheme and a company are different legal entities, established for inherently different purposes. A scheme is operated on a fiduciary basis for the benefit of its members and the role of a responsible entity is not the same as a normal company. We are not aware of any regulatory imperative to justify the extent of the proposed changes. Some of CAMAC's proposals would require substantial structural arrangements to MIS imposing substantial costs.

We also note the CAMAC did not appear to have regard to the interaction of its proposals with other legislative proposals and regimes, in particular:

- superannuation legislation, given a large proportion of funds in MIS are from superannuation funds;
- listing rules, which creates anomalies for listed MIS dealing with listed requirements designed for companies and MIS rules designed primarily for unlisted, retail MIS;
- taxation law which provides very different treatment between a MIS and a company
- legislative developments, such as the Asia region funds passport.

Subject to these general observations, we have the following specific comments on the items listed above which were identified in the Interim Report as examples of the CAMAC recommendations considered by the Inquiry.

MIS as a separate legal entity

We support the development of an internationally recognised corporate vehicle for MIS in Australia. We believe that such a vehicle will make Australian funds management services more internationally competitive. It is however also be critical to implement fully the recommendations of the Johnson Report, in particular relating to tax of MIS. It would also be important to obtain appropriate tax relief to allow rationalisation of MIS into the new structure.

If Australia adopts a corporate structure for MIS, then it would be normal for the investment manager to be appointed by the MIS as its agent. There would not be any need for an RE as such.

Review structural requirements and definitions

There are deficiencies in existing MIS definitions and requirements, some of which are highlighted by CAMAC. However, care will need to be taken to ensure that any changes do not have unintended consequences. For example, reviewing the definition of 'liquid assets' would be welcome having regard to the original objectives of the liquidity and withdrawal provisions. However, this needs to be done carefully as products have been structured based on the current definition.

Product rationalisation

The Interim Report has sought submissions on the following matters: 3-87

- Government to renew consideration of 2009 proposals on product rationalisation of legacy products.

Minter Ellison response

While we do not support the restrictive and prescriptive regime proposed by Treasury in its Proposals Paper in 2009, we do believe that this is an important matter for the Inquiry to consider. Establishing a robust and practical product rationalisation regime (such as the existing superannuation successor fund transfer regime) for the managed investment and life insurance industries will do much to increase the efficiency of the Australian financial system.

We submit that the Inquiry should make recommendations about the appropriate structure of a product rationalisation regime having regard to the submissions made to the Treasury in 2010. We also believe that it is important for the Inquiry to make strong observations about the tax relief required to facilitate product rationalisation as we do not believe that it is feasible for a successful product rationalisation scheme to be implemented without appropriate tax relief.

Consumer loss and compensation

The Interim Report has sought submissions on the following matters: 3-86

- Given the limitations of professional indemnity insurance, what options, if any, exist for addressing the issue of consumer loss?
    - Implementation of a statutory compensation scheme?
    - Increase ASIC's resourcing and capability for proactive surveillance of its regulated population?

Minter Ellison response

We do not believe that a statutory compensation scheme is an appropriate response to addressing consumer loss. Such a scheme has been considered and rejected consistently in the past, as noted by the Inquiry most recently by Richard St John in the report released in 2012. Richard St John stated:

> *I have concluded that it would be inappropriate, and possibly counter-productive, to introduce a more comprehensive last resort compensation scheme to underpin the current relatively light compensation regime for financial advisers and other providers of financial services. Given the limited regulatory measures to protect retail clients from the risk of licensee insolvency, it would be inappropriate to require more responsible and financially secure licensees to underwrite the ability of other licensees to meet claims against them for compensation. There would also be an element of regulatory moral hazard should a last resort scheme be introduced without a greater effort first to put licensees in a position where they can meet compensation claims from retail clients. It would reduce the incentive for stringent regulation or rigorous administration of the compensation arrangements.*
> (page iii)

We remain concerned that a statutory compensation scheme would lead better-run providers being liable for losses caused by those who disregard their legal obligations and would increase moral hazard in the system. Richard St John goes on to recommend a more rigorous to compliance and a more stringent approach to licensing. We believe that effective risk-weighted supervision is a critical component of measures to reduce the risk of consumer loss, along with a targeted licensing system which identifies and actively monitors higher risk providers and activities. This in turn makes it imperative that ASIC has the resources and capability required to undertake its role.

Other matters

Passporting

While the current Asian Region Funds Passport initiative is welcome, we note that it is limited and needs to be significantly expanded to facilitate the export of financial services to the region as we discuss on page 38.

Disclosure

As we discuss on page 13, the current disclosure regime has failed. In relation to MIS, the current product disclosure regime provides for a number of different types of disclosure depending upon the particular type of MIS product – including, for example, short form PDSs, long form PDSs and additional disclosure requirements for certain types of funds such as 'hedge funds'. These requirements are documented in a combination of legalisation and ASIC policy. As a result, the current regime involves complexities which inhibits the efficient bringing to market of MIS products.

We believe that the Inquiry should implement the four disclosure principles we have set out on page 13 to facilitate the efficient bring of products to market.

Appendix J: Payments

Retail payments systems regulation

The Interim Report has sought submissions on the following matters: 3-106

- Is there firm evidence to support opportunities for simplifying the regulatory framework for retail payment systems and participants?
- What are practical and appropriate options to simplify the current regulatory framework for retail payment systems and participants?
- Consider a graduated framework for retail payment system regulation to provide protection for customer funds with clear and transparent thresholds.

Minter Ellison response

Technology is radically changing the way Australians pay. Traditional bank-dominated payment mechanisms are being disrupted by systems which rely on contactless technology, mobile phone operability and crypto-currencies.

New payment technologies will benefit both the private sector and consumers. Real time payments, for example, will enable businesses to better manage cash flows and improve working capital. New entrants to the financial sector will increase competition, creating efficiencies and driving downs costs for consumers. For these reasons, the regulatory system should promote and protect new payment systems.

The majority of submissions to the Inquiry have advocated for a balanced approach to new payment systems which guarantees security and stability without stifling innovation. Whilst we support regulation which achieves this balance, we submit that the government should adopt a 'light touch' approach which incentivises innovation without unduly burdening new entrants to the financial services market.

Specifically, we recommend that:

- the regulatory setting be flexible so as to accommodate technological change;
- the system does not discriminate against, and where necessary protects, new entrants. These include start-ups and niche providers as well as already established companies seeking to enter the financial services market for the first time;
- regulatory mechanisms do not needlessly interfere with market forces which promote innovation; and
- financial services regulators have specific mandates to consider and protect technological innovation. It is our view that the 'Project Innovate' initiative, run by the United Kingdom's Financial Conduct Authority (**FCA**), is a strong model because, amongst other things, the FCA is able to incubate new firms from certain regulatory requirements.

Appendix K: Superannuation

Policy settings

The Inquiry has sought submissions on the following matters: 2-120

- The Government seeking Parliament's agreement to the objectives of the superannuation and retirement incomes system, so any future changes can be judged against these objectives.

Minter Ellison response

We agree that superannuation policy settings lack stability and that this adds to the costs and reduces the long-term confidence and trust in the system. We also believe that implementation costs are compounded by poor consultation with industry (see our comments on page 10), overlapping and inconsistent regulatory initiatives, overly prescriptive regulatory requirements and inadequate and inconsistent transition periods and grandfathering regimes.

There is merit in seeking bipartisan agreement to document the objectives of the superannuation and retirement incomes system. It is not of course possible for legislation to bind future governments without constitutional amendment – legislation can be altered by future parliaments. However, we believe that a bipartisan approach to superannuation and retirement income policy, and indeed regulation of the financial system, is critical to attaining the dual aims of encouraging private savings for retirement and addressing the demographic challenge by reducing the ultimate burden on the taxpayer.

Ultimately, the critical need for the superannuation and retirement incomes system is to depoliticise the agenda. This has been successfully achieved in other areas of national endeavour through the appointment of an independent body with authority to adjust settings in accordance with an agreed mandate. The Reserve Bank's role in setting monetary policy is an example of a body performing such a function in a manner that largely removes the issues from the political debate and provides the level of certainty required by the financial system and economy to function efficiently. Other somewhat less successful examples are the roles performed by various remuneration tribunals, such as Fair Work Australia and the Parliamentary Remuneration Tribunal.

The Inquiry might like to give consideration how a similar body could be established with responsibility for superannuation and retirement income settings within the context of a broadly agreed mandate for the system.

Regulatory structure

The Inquiry has sought submissions on the following matters:

- Is the trust structure is best placed to meet the needs of members in a cost-effective manner? 2-115

Minter Ellison response

We support the trust structure as the most appropriate structure for superannuation. Any other structure would significant legislative intervention to replicate the protective features of the trust and to ensure member interests are aligned with the entity responsible for the management of the fund.

- Regulate APRA-regulated superannuation trustees and funds in the same way as responsible entities and registered management investment schemes (MISs). 3-102

Minter Ellison response

We are not convinced that superannuation funds and MISs should be regulated differently. They perform the same role of pooling member assets for the benefit of members. In our view, defined contribution schemes which make up the vast majority of Australian superannuation funds do not require prudential regulation, the essential element of which is to ensure that financial institutions have sufficient financial assets to be able to meet the promises they have made to consumers. Of course, defined benefit funds do require some form of prudential regulation where they are not simply a vehicle for offering prudentially regulated products offered by another financial institution, such as a life company.

Prudential requirements are not needed for a trust relationship where members have an unallocated interest in the trust property. Apart from the compulsory nature of superannuation, there is no reason to think that superannuation trustees should be held to a higher standard than responsible entities of registered scheme – both should surely be held to the highest reasonable standards of conduct, probity and competence.

Nevertheless, we do not believe that there is any need for an immediate change to the form of regulation for superannuation. In the absence of a case for pressing reform, we do not believe that any such change should be considered at the present time given the reform cost and fatigue that the superannuation sector has borne in recent times.

Retirement income

The Interim Report has sought submissions on the following matters:

- Would deferred lifetime annuities or group self-annuitisation be useful products for Australian retirees, including for protecting against longevity risk? Are there examples of other potentially suitable products? 4-32

- If part of retirees' superannuation benefits were to default into an income stream product, which product(s) would be appropriate?
- Will the private sector be able to manage longevity risk if there is a large increase in the use of longevity-protected products? How could this be achieved?
- Should Government increase its provision of longevity insurance? How would institutional arrangements be established to ensure they were stable and not subject to political interference?
- What are some appropriate ways to assess and compare retirement income products? Is 'income efficiency' a useful measure?

Minter Ellison response

We support the availability of a wider range of retirement income products to provide retirees with more options for funding their retirement. Examples of products that may be useful in addressing longevity risks include:

- deferred lifetime annuities; and
- hybrid products such as a combination of a currently payable account-based pension and a deferred pension.

- Maintain the status quo with improved provision of financial advice and removal of impediments to product development. 4-25
- Provide policy incentives to encourage retirees to purchase retirement income products that help manage longevity and other risks.
- Introduce a default option for how individuals take their retirement benefits.
- Mandate the use of particular retirement income products (in full or in part, or for later stages of retirement).

Minter Ellison response

We do not believe that maintaining the status quo with improved provision of financial advice will address the concerns raised by the Inquiry. We believe that promoting product innovation and demand for retirement income products requires:

- removing legal and regulatory impediments to product development (such as the inflexible pension rules in the *Superannuation Industry (Supervision) Regulations*); and
- providing policy incentives (eg tax incentives) to encourage superannuation funds to offer and retirees to purchase retirement income products.

This will assist in managing the challenges presented by Australia's ageing population.

We do not support mandating the use of particular retirement income products (whether in full or in part, or for later stages of retirement). Retirees do not all have the same needs in relation to retirement incomes. A retiree with investments outside superannuation not have the same needs as a retiree that did not. Further, a retiree may need to access lump sums for good reason (such as for medical treatment or to modify their home for special needs).

Retirees should be able to continue choosing the form of retirement income which suits their circumstances. It is therefore important for providers to be encouraged to produce innovative products that deal with the varying needs of retirees and for retirees be incentivised to take out those products.

We believe there is merit in considering the introduction of a default option for how individuals to take 50% of their retirement benefits as a retirement income product. However, it is important that retirees should be able to opt out of that default (without financial penalty). It is also important that any default be introduced in a way that can be delivered at a low cost, consistent with the reasons for introducing MySuper as a default product. Furthermore the default should not apply where a retiree's account balance was relatively small as it would not serve the interests of a retiree to acquire a retirement income product generating less than say $5000 pa or approximately $100 pw.

- Take a more flexible, principles-based approach to determining the eligibility of retirement income products for tax concessions and their treatment by the age pension means test. 4-31
- Streamline administrative arrangements for assessing the eligibility for tax concessions and age pension means test treatment of retirement income products for product providers.
- Issue longer-dated Government bonds, including inflation-linked bonds, to support the development of retirement income products.

Minter Ellison response

There is a clear need for streamlined administrative arrangements between the superannuation system and aged pension systems. They are clearly complementary and inter-related in their intended outcomes. The tax concessions provided under the superannuation system however should not be available as a simple 'means test'. The superannuation system tax concessions should not be removed or diluted so as to result in tax at all levels of superannuation contribution, accumulation and distribution phases. This would otherwise undermine the incentive for Australians to 'save' for their retirement phase and place undue pressure on the Government funded age pension. The current design arrangements where tax concessions are available on the income or distribution phase are appropriate and should be retained. However some 'tax concession' on contributions is also appropriate to encourage 'savings', including as a means tested incentive.

We support the adoption of a more flexible, principles-based approach to determining the eligibility of retirement income products for tax concessions and their treatment by the age pension means tests. In our view, the provision of tax exemptions to superannuation funds on income earned on fund assets which support only current (as opposed to future) pension liabilities acts as a barrier to the creation of innovative retirement income products and does not incentivise the development of products that convert into retirement income products at the relevant point in time.

We also note that the following affect demand for retirement income products:

- retirement income products purchased on or after 20 September 2007 are fully assessed for the purposes of the assets test; and
- the age pension means tests are applied to deferred lifetime annuities, even during the deferral period.

There should be a more flexible, principles-based approach to determining the eligibility of retirement income products for tax concessions and their treatment by the age pension means tests.

SMSFs

The Inquiry has sought submissions on the following matters: 2-126

- Should the Inquiry be concerned about the high operating expenses of many self-managed superannuation funds (SMSFs)?
- Should there be any limitations on their establishment?

Minter Ellison response

We are not aware of anything to suggest that consumers are not able to determine and understand the costs of establishing and operating an SMSF, or to make comparisons with the costs of other superannuation options.

The establishment of an SMSF is an 'active' choice when made and demonstrates a level of engagement which is otherwise uncommon in superannuation.

We do not therefore support the imposition of a minimum size to establish as SMSF. A small initial establishment amount may for example be appropriate where future transfers and contributions will result in the fund being of a more substantial size.

SME access to funding

The Interim Report has sought submissions on the following matters: 2-67

- Encourage superannuation funds to invest in securitised SME loans and venture capital funds.
- Require superannuation funds to engage appropriate expertise to invest in venture capital funds.

Minter Ellison response

We do not support any suggestion that superannuation funds should be required to invest a proportion of their assets in any particular way. In our view, this will ultimately lead to less efficient and potentially lower returns at an increase risk to retirement assets. These matters should be left to each superannuation trustee to determine the best course of action for the benefit of their members. Of course, any tax or other benefits that may be available in relation to particular kinds of socially desirable assets are likely to increase their attractiveness to superannuation trustees for the benefit of their members.

Appendix L: Technology and privacy

Technology neutrality and facilitating innovation

The Interim Report has sought submissions on the following matters:

- Amend regulation that specifies using certain technologies with the aim of becoming technology neutral. Electronic service delivery should be the default with appropriate opt-out provisions. 4-44
- What specific regulatory and legislative requirements should be prioritised for amendment in relation to technology neutrality? 4-45
- Adopt a principle of technology neutrality, for future regulation recognising the need for technology-specific regulation on an exceptions basis. Where technology-specific regulation is required, seek to be technology neutral within that class of technologies.
- Are there specific areas in which Government or regulators need to facilitate innovation through regulation or coordinated action? For example, by facilitating the development of central utilities? 4-51
- Are there ways to improve how regulators monitor or address emerging technological developments? For example, through adopting new technologies or mechanisms for industry intelligence gathering?
- Establish a central mechanism or body for monitoring and advising Government on technology and innovation. Consider, for example, a public-private sector collaborative body or changing the mandate of an existing body to include technology and innovation.
- Establish a whole-of-Government technology strategy to enable innovation.

Minter Ellison response

The Inquiry correctly identifies that laws which are not technology neutral stifle business innovation. Legislation which requires physical documents to be used for data storage, lodgement and evidentiary purposes provides a disincentive for business to develop new and more efficient service models. The objective should be a regulatory system which allows business to be carried out digitally end-to-end.

The current problem is two-fold. First, some regulation specifically requires businesses to use physical documents in certain processes. Examples include disclosure and consent requirements as well as authentication and signature standards. Second, some regulation is not technology neutral, meaning that businesses are required to use paper-based systems even though this may not have been the intention of policy makers.

To address these issues, we submit that the Inquiry should:

- consider if and how all pre-existing statutory requirements which require paper-based processes can be modified to allow businesses to comply by using electronic methods;
- consider which current statutory requirements are not technology neutral and propose amendments to rectify ambiguities. The Inquiry may wish to consider whether amendments to the *Acts Interpretation Act 1901* (Cth) and the Commonwealth, State and Territory *Electronic Transactions Acts* are required in order to facilitate this process; and
- impose a principle of technology neutrality on future regulation. Amongst other things, this will involve developing drafting techniques to further clarify statutory terms such as 'document', 'record', 'copy', 'cover', 'signature' etc.

Achieving technology neutrality will require systemic legislative change and involve further investment. It is our view that this investment must happen now so that Australia's legal system can keep pace with its advanced digital economy.

Refer also to our comments on Disclosure in Appendix C.

Data privacy and security

The Interim Report has sought submissions on the following matters: 4-55

- What options could be explored for providing consumers with more control over use of their data and/or better access to their own data in useful formats to improve decision making and consumer outcomes?

Minter Ellison response

Financial sector participants are collecting and storing growing volumes and types of customer data. While many financial sector participants are using such information in order to create new products, enhanced product functionality and better customer service, there are varying levels of risk associated with the mishandling and misuse of those increased amounts and types of personal information.

In order to meet these competing demands, one option for providing consumers with more control over use of their data could be the introduction of a standardised financial sector privacy disclosure.

The purpose would be to provide consumers with access to information about the standard practices in the relevant industry sector about way their data will be collected, disclosed and handled.

Standardised disclosure would include the items of personal information which it is agreed is appropriate for the industry to collect, as well as how the industry members use that information. It would represent a single source of information for consumers regarding industry practice with respect to personal information. It could be referred to when personal information is collected or a link provided on a website. Specific information would then only need to be provided to the extent that the provider's practices deviated from the standard disclosure. The standard disclosure could be derived from the factors presently required under APP 5 (notification of the collection of personal information) and could be presented in a form agreed to at an industry level.

In terms of providing better access to personal information by financial sector participants, it is difficult to see how better access could be provided outside the current requirements stipulated in the Privacy Act.

- What additional Government data sets could be released to improve consumer outcomes, industry analysis and public policy development via data.gov.au, taking into account relevant privacy requirements?

Minter Ellison response

Given the financial services industry is often subject to privacy complaints which may arise out of miscommunication and misunderstanding, it may be helpful if more detailed industry-specific statistics regarding complaints are able to be provided to enable the industry to address these issues. This information could identify on an anonymous basis the precise systemic faults or circumstances which lead to the particular complaint, and what the entity has done to remedy the issue. The findings could be beneficial from a deterrent, educational and policy perspective, potentially leading to industry change in systems and procedures which could lead to consumer benefits.

- Review and assess the new privacy requirements two years after implementation to consider whether the impacts appropriately balance financial system efficiency and privacy protections. 4-55
- Review record–keeping and privacy requirements that impact on cross-border information flows and explore options for improving cross-border mutual regulatory recognition in these areas.
- Implement mandatory data breach notifications to affected individuals and the relevant regulator. 4-58
- Principles-based guidance from APRA for use of cloud computing technology, with a focus on the benefits as well as the risks.

Minter Ellison response

It is our experience that, in the event of a data breach incident, responsible members of industry will deal with the incident in accordance with the Office of the Australian Information Commissioner's *Data breach notification: a guide to handling personal information security breaches*, and this Guide works effectively to assist entities to respond to a data breach involving personal information that they hold. We consider the threat of reputational damage is also a sufficient deterrent to encourage compliance both with the Guide and with the Privacy Act. There is no evidence of which we are aware to justify a significant departure from the status quo.

Cyber security

The Interim Report has sought submissions on the following matters:

- Review and update the 2009 Cyber Security Strategy to reflect changes in the threat environment, improve cohesion in policy implementation and progress public–private sector collaboration. 4-63
- Would a private–public sector discussion forum for strategic issues, such as cyber crisis planning, improve cohesion in implementing cyber security policy? What other mechanisms might assist to improve cohesion or coordination?
- Is there a need for more cross-sectoral or transnational mechanisms for information sharing, or for Government to work with industry to initiate the development of a collaborative model similar to the United States FS-ISAC?
- How useful would a voluntary cyber security framework, similar to that of the United States NIST, be in assisting industry to develop cyber capabilities?

Minter Ellison response

The Inquiry has correctly identified that there is a severe cyber security risk facing Australian businesses, as well as inadequate regulatory infrastructure to provide the necessary protections. In our view, the overarching problem is that the government frames cyber security as a shared risk, but does little to assist the private sector to address the threat. Government support in this area is particularly important because it possesses the intelligence-gathering capability to identify threats and the know-how to defend against a range of threat actors ranging from foreign intelligence services to terrorists to criminal enterprise.

The Inquiry has suggested updating Australia's outdated Cyber Security Strategy (CSS). We agree that the CSS should be updated and propose that it should lay the foundation for a strong partnership between government and the private sector. Specifically, a new CSS should allow for:

- information sharing between government and the private sector. Threat information should be released in full, in real time and in a manner which companies can practically respond to; and
- mechanisms for intelligence agencies to actively support the private sector. While it is current government policy to allow opportunities for select private sector employees to embed with security services to learn more about addressing cyber threats, the government should consider more practical ways to assist the private sector. As different companies will face different risks (largely depending upon on their assets and size), the government should

not take a one-size fits all approach. For example, the government could offer services to companies without relevant in-house expertise whereby it tests existing cyber protections and advises on how these could be strengthened. Additionally, the government could publish cyber security guidance notes which are tailored for different business models.

As with other types of criminal behaviour, the government should not just consider how to defend against cyber attacks but also how to respond. The Interim Report did not address the efficacy of the new offences introduced in the *Criminal Code Act 1995 (Cth)* which target cyber crime. We recommend that these laws be reviewed and that consideration be given to:

- whether the offences are wide enough to capture new forms of cyber crime;
- whether the penalties reflect the severity of the offences and operate as a useful disincentive; and
- how the evidentiary difficulties in prosecuting cyber crime offences can be overcome.

Appendix M: International integration

The Inquiry seeks further information on the following areas:

- What are the potential impediments to integration, particularly their relative importance, and the benefits to the broader Australian economy that can be demonstrated if they were removed? *Impediments noted in submissions included:* 4-88
    - *Ownership restrictions*
    - *Licensing costs and requirements*
    - *Inconsistent prudential settings*
    - *Requirements affecting cross-border data flows, eg record keeping requirements*
    - *Better codification of our trust law*
    - *Lack of access to certain treaties and quotas*
    - *Anomalies between Australian and overseas governance requirements.*

Minter Ellison response

We reiterate the comments in our previous submission that the key issues to leverage our domestic capability internationally are choice of investment vehicle (discussed in Appendix I), tax and passporting (discussed below).

Tax reform is critical to facilitate the use of a broader use of vehicles for investment funds in Australia. We discuss this and related tax issues in Appendix A of our previous submission.

There are other impediments, including Australian company law which is not as flexible as the company law regimes of other jurisdictions where companies are used as investment vehicles.

- Where is future Government engagement needed to facilitate integration with Asia?

Minter Ellison response

Passporting

The ability to market Australian funds and investment management services is crucial to our ability to export these services. The recently announced pilot for Asian Region Funds Passport involving Australia, South Korea, Singapore and New Zealand is a welcome development. However, it is crucial that other countries become involved, in particular those with a high level of funds under management and those with the potential to grow funds under management significantly. We also note that the Asian Region Funds Passport is limited to:

- retail funds;
- the operation of funds and not the marketing of those funds;
- services relating to funds and not the provision of other investment management services.[2]

We consider that reciprocal recognition of licensing regimes more generally would also be a goal worth pursuing, not only in Asia but globally.

- What improvements could be made to domestic regulatory process to have regard to foreign regulatory developments impacting Australia? 4-98
- Are there priority jurisdictions and activities that might benefit from further mutual recognition or other arrangements? What are the identified costs and benefits that might accrue from such an arrangement?

Minter Ellison response

AML/CTF regime

In addition to the areas discussed in the Interim Report, one area that appears to be overlooked is the poor integration of the Australian anti-money laundering and counter-terrorism financing (AML/CTF) regime with global regimes. We reiterate the concerns we raised on page 10 of our previous submission which cause global businesses to incur additional cost to operate in Australia and Australian businesses to incur additional costs to operate globally. The Australian regime should be made more consistent with regimes in other key jurisdictions and compliance with an AML/CTF regime in another full member of the Financial Action Task Force (FATF) should be sufficient to meet Australian requirements.

AML/CTF regulation would therefore significantly benefit from mutual recognition. In particular, mutual recognition between the Australian and New Zealand regimes would be very beneficial given the integrated nature of the trans-Tasman economy. However, we believe that mutual recognition in this area should be extended to all FAFT members. We submit that a consistent global system of AML/CTF regulation is crucial not only for economic reasons but also to maximise the effectiveness of this costly regime. Australia should be actively working with regional and global partners to develop a single global AML/CTF regime which is implemented globally on a consistent basis.

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[2] http://www.fsc.org.au/policy/global-markets/asian-region-funds-passport.aspx#Passport_Pilot

Appendix N: Governance

The Interim Report has sought submissions on the following matters: 3-48

- Is it appropriate for directors in different parts of the financial system to have different duties? For example, different duties apply to directors of banks and insurers and trustees of superannuation funds. Who should directors' primary duty be to?

Minter Ellison response

We submit that the current law regarding the duties of directors of regulated bodies such as banks, life companies, responsible entities and superannuation trustees, though complex, is appropriate.

The fundamental duty of directors of all companies is to act in good faith in the best interests of their company. Where the company is not a subsidiary and is not approaching insolvency, the directors are required to act in the medium to long-term interests of the shareholders as a whole. If the company is approaching insolvency, the directors must have regard to the interests of creditors and may need to give creditors priority to the interests of shareholders. Where the company is a subsidiary in a group, the directors of the subsidiary may be authorised by that company's constitution to act in the best interests of the parent company.

However, if the parent company or a subsidiary is a bank, life company, responsible entity or superannuation trustee, there are special protections for, respectively, depositors and policy owners and holders of registered scheme interests and beneficiaries. In some cases, there is an express requirement for the directors of the company to take reasonable care to ensure that priority is given to the interests of the relevant stakeholders over the interests of shareholders of the company or its parent.

In our view, the statutory provisions provide an important protection for the stakeholders when the directors are making decisions regarding transactions with third parties (or even subsidiaries within the same group as the company) that might benefit shareholders but put the interests of those stakeholders at risk.

However, we submit that the law should more clearly acknowledge the role played by the judgment of directors, and should ensure that directors are not at risk of liability if they make a decision in good faith, exercising their business judgment while endeavouring to give priority to the interests of stakeholders. In other words, directors should have the benefit of an effective business judgment rule which extends to protect directors of regulated bodies that have statutory duties to other stakeholders as well as to shareholders.

- Review prudential requirements on boards to ensure they do not draw boards into operational matters.
- Regulators continue to clarify their expectations on the role of boards.

Minter Ellison response

We submit that in certain recent pronouncements, APRA has shown a regrettable tendency to misunderstand the relationship between the board of directors and the management team, by expecting directors to take responsibility for matters of detailed management. This was particularly evident in APRA's recent risk management releases, namely CPS 220 as adopted in 2013, and draft CPG 220 released in January 2014. In response to submissions, APRA has modified its approach and it is anticipated that revisions of those documents will be published shortly. However the problem is exemplified by other prudential standards and APRA guidance, for example CPS 510.

APRA is in a difficult position because it is under pressure in the international context to adopt an increasingly granular role in its supervision of boards of directors of regulated entities. However, we suggest that if it adopts a regulatory strategy based on sound corporate governance and hence reflecting the proper roles of the board and management, APRA could provide leadership to prudential regulators in other countries.

We believe adopting regulatory strategies that reflect good corporate governance will be essential for the health and efficiency of the Australian financial system. We therefore urge the Inquiry to recommend that APRA should continue its review of prudential requirements on boards to ensure they do not draw boards into operational matters, and that all Australian regulators should provide greater clarity regarding their expectations of the role of boards.

We also recommend that as a matter of priority, the statutory business judgment rule for company directors, which is presently ineffective, be revised so that Australian company directors, like their US counterparts, can have real confidence that the decisions they make in good faith in the exercise of their business judgment will not be second-guessed by courts and regulators after the event.

Appendix O: External administration

The Interim Report has sought submissions on the following matters: 2-71

- Is there evidence that Australia's external administration regime causes otherwise viable businesses to fail and, if so, what could be done to address this?

Minter Ellison response

Australia's insolvent trading laws are among the strictest of any country. Without citing client specific examples, we submit that the insolvent trading regime is overly strict and places an inappropriate burden on directors.

In the past, there has been concern that a relaxation of Australia's insolvent trading laws would simply encourage directors to enter administration at a later stage. We submit that this concern can be largely confined to small and medium enterprises (**SMEs**), where directors usually have a greater level of personal investment and may not be professional directors.

In contrast, listed companies employ professional directors who generally have less personal investment and greater concerns about reputation. Further, listed companies are subject to a far greater level of oversight than SMEs, including continuous disclosure laws. Accordingly, directors of listed companies are less likely to prolong trading beyond what may be considered reasonable to implement a corporate restructure, in response to a relaxation of the insolvent trading regime.

We submit that a layered insolvent trading regime should be established, introducing a safe harbour defence specific to listed companies. This safe harbour would permit trading where a restructure plan has been approved by a qualified professional and has a reasonable probability of success. The safe harbour should be dependent on regular review of the restructure plan by the qualified professional.

- Implement elements of the US Chapter 11 regime.
- Implement the 2012 proposals to reduce the complexity and cost of external administration for SMEs.

Minter Ellison response

We broadly agree with the Inquiry that implementation of the US Chapter 11 regime is inadvisable. However, we recognise that there are still some valid areas for micro-reform within the existing voluntary administration regime.

In particular, we submit that the moratorium during voluntary administration should be strengthened in relation to ipso facto clauses. Ipso facto clauses allow a contract to be terminated by a counterparty in the event of insolvency. Where a company entering voluntary administration is operationally dependent on contractual rights (for example, where a party holds licences that are required for day to day operations), exercise of such a clause is a significant impediment to a successful turnaround. Accordingly, we submit that the Inquiry should recommend the prohibition of ipso facto clauses while a company is in voluntary administration.

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