4 February 2022

Senate Standing Committees on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

By email: economics.sen@aph.gov.au

Dear Sir/Madam,

Supplementary submission - Financial Accountability Regime Bill 2021 and Financial Services Compensation Scheme of Last Resort Levy Bill 2021 and related bills

The Law Council of Australia is grateful for the opportunity to provide this supplementary submission to the Senate Standing Committees on Economics (**the Committee**) inquiry into the Financial Accountability Regime (**FAR**) Bill 2021 (**the Bill**) and Financial Services Compensation Scheme of Last Resort Levy Bill 2021 and related bills.

The below supplementary submission seeks to provide answers to questions on notice that were agreed to during the Law Council's appearance before the Committee on Thursday 27 January 2022.

Response to King & Wood Mallesons submission

During the course of the Law Council's appearance, the Committee Chair asked the Law Council to respond to the recommendations that were made in the King & Wood Mallesons (**KWM**) submission dated 17 December 2021. The below provides the Law Council's response to five of KWM's submissions.

Submission 1: Extension of FAR to "significant related entities" of RSE licensees

- KWM raises a number of concerns and proposes '*requiring one group executive with general management responsibility for the RSE licensee to be an accountable person, in addition to the directors and management of the RSE licensee itself to whom the FAR requirements would already apply. This would be directly analogous to the regime that applies to foreign banks, where the "senior officer outside Australia" is required by APRA to be an accountable person.*'

- The Law Council agrees with KWM's concerns regarding the breadth of the definition of "significant related entities", particularly as it is unclear as to the regulatory justification for this extension. Other accountable entities can likewise be structured in different ways (similar to superannuation entities).

- Our preferred position is that the definition for significant related entities for RSE Licensees should be the same (narrower definition) as the other accountable

entities. In this context, the Law Council is comfortable with the proposal put forward by KWM set out above.

- *Submission 2: Civil penalties should not be imposed on individuals without fault*

- KWM is concerned that the civil penalties described in FAR apply even where the offender has not intentionally contravened the law. They propose: *civil penalties could only be imposed on individuals who have been involved in a contravention by the accountable entity (in the circumstances as described in the FAR Bill), and who have also acted dishonestly, intentionally or recklessly. We think this is the intention and at the very least should be confirmed in the Explanatory Memorandum for the FAR Bill.*

- The Law Council's primary submission remains that no civil penalty provisions should be included in the Bill (see p. 8, [24]-[25] of the Law Council's submissions on FAR). However, if any civil penalty provision is included, we agree it is preferable to limit it so it does not apply where the offender has not intentionally contravened the law.

Submission 3: Continued overlap and 'stepping stones' risk with obligations on individuals to ensure compliance with financial services laws

- KWM submits the individual accountability obligation is essentially an obligation to comply with existing obligations and is onerous.

- The Law Council agrees with this and raises the same concerns at pages 6-7, [11]-[14] of the Law Council's initial submission to the Committee.

Submission 4: Prescribed "accountable person" roles continue to require clarification

- KWM is concerned that: *The consultation materials released in July 2021 included the "Financial Accountability Regime – List of prescribed responsibilities and positions – Policy Proposal Paper", which set out the Government's proposal regarding the responsibilities and positions that should result in a person being an Accountable Person. The FAR Bill provides for these matters to be addressed in the Minister Rules, which have not yet been released for consultation.*

- The Law Council agrees that ideally consultation should occur before passage of the Bill.

Submission 5: Timing

- KWM submits: *The FAR Bill is expressed to apply to ADIs from the later of 1 July 2022 or the date that is 6 months after the commencement of the Act. If the latter approach applies (due to a delay in the passage of the FAR Bill) then we note that there is a possibility that obligations could begin applying to ADIs mid-month. To assist in business certainty and smooth the transition, we would recommend that the obligations begin to apply from the first day of a calendar month.*

- The Law Council would have no objection to what is proposed.

Managed investment schemes

Senator Pratt asked if the Law Council had a view on "bringing managed investment schemes in" and whether it had "any sense of what unpaid determinations Australian Financial Complaints Authority (**AFCA**) currently have for products that aren't managed investment schemes".

Compensation under the proposed statutory compensation scheme of last resort (**CSLR**) would only be potentially payable to a consumer in respect of a "relevant AFCA determination".

A "relevant AFCA determination" would be defined in proposed section 1065 as one which related to one or more of:

- engaging in credit activity;
- providing personal financial product advice to a person as a retail client about one or more "relevant financial products" (within the meaning of Part 7.6 of the *Corporations Act 2001* (Cth) (**Corporations Act**));
- dealing in securities for a person as a retail client, other than issuing securities.

In Part 7.6 of the Corporations Act, a "relevant financial product" is any financial product that is not a basic banking product, general insurance product or consumer credit insurance. It would include securities, interests in managed investment schemes as well as several other types of financial products.

The scope of financial products for which personal advice is given which can be the subject of a "relevant AFCA determination" is broader than those for which dealing services are provided. This means a consumer's eligibility to receive compensation can be impacted by whether or not they obtained financial advice, and there are some scenarios where a consumer who received financial advice may be eligible for compensation and a consumer who invested without seeking advice will not.

The Financial Services Committee of the Law Council's Business Law Section (**FSC**) in its submission of 17 December 2021 to the Committee relating to the Financial Sector Reform (Hayne Royal Commission Response No. 3) Bill 2021 (**Hayne Bill**) was unable to identify a rationale for why a dealing activity relating to shares in a company (which are securities) could be the subject of a "relevant AFCA determination", whereas a dealing activity relating to units in a managed fund (which are interests in a managed investment scheme and are not securities) could not.

As noted in the submission, the FSC was uncertain whether the drafters of the Hayne Bill had been potentially labouring under a misapprehension that the reference to "securities" would include interests in managed investment schemes (such as units in a managed funds). When used in Chapter 7 of the Corporations Act, the term "securities" has the meaning given in section 761A of the Corporations Act and only includes an interest in a managed investment scheme when it is used in Part 7.11.

It appears that there were submissions made to the Committee, and discussed at some length at the Hearing, to the effect that AFCA determinations made against the *operators* of managed investment schemes should be "relevant AFCA determinations". To bring operators of managed investment schemes within the scope of the CSLR, the definition of "relevant AFCA determination" would need to both include dealing in interests in a managed

investment scheme *and* exclude the current "other than issuing" wording with regard to interests in managed investment schemes.

The FSC's comment on the drafting as to which "dealing" services could be a "relevant AFCA determination" to which the CSLR would apply was *not* intended to question the policy of excluding unpaid determinations against financial product issuers (such as the operators of managed investment schemes) from the CSLR (and this is not a matter on which the FSC seeks to express a view). The FSC agrees that any expansion to the scope of the CSLR would require proper and thorough analysis of the financial and legal consequences, which would demand additional time and resources.

The FSC is not armed with information of the nature that the Committee seeks on unpaid AFCA determinations and is of the view that AFCA is the appropriate body to provide that information.

Senator Pratt also asked the Law Council to "look at the DH Flinders case". The case of *D H Flinders Pty Ltd v Australian Financial Complaints Authority Limited* [2020] NSWSC 1690 involved a situation where the AFCA rules in place at the time did not provide AFCA with jurisdiction to deal with complaints made against DH Flinders Pty Ltd (the **Licensee**) in circumstances where a former authorised representative of the Licensee had acted outside of the scope of their authority. The complaints were made about a financial product that the authorised representative had offered without the knowledge of the Licensee.

The AFCA rules have since been amended to better align them with the liability regime under the Corporations Act. The FSC understands that those amendments were designed to ensure that, going forward, AFCA has jurisdiction to deal with complaints made about acts of authorised representatives of a licensee that were outside the scope of authority given by the licensee.

The FSC notes that the Licensee in the DH Flinders case was not the issuer of the financial product about which was the subject of the AFCA complaints and is not in a position to make specific comments about what kind of financial product it was, who the issuer of that product was and whether or not the issuer was an AFCA member. The FSC notes that a licensee cannot give a representative authority to issue a financial product under an authorised representative appointment, so the Licensee in the DH Flinders case could not have been treated as responsible for the *issuing* of the products that were the subject of the complaints in any event.

ASIC licence cancellation power

In the FSC's submission, the FSC also expressed concern about the proposed amendments to section 915B of the Corporations Act and section 54 of the *National Consumer Credit Protection Act 2009* (Cth), which would require the Australian Securities and Investments Commission (**ASIC**) to cancel the Australian financial services licence or Australian credit licence (as applicable) if the licensee had been the subject of a "relevant AFCA determination" for which compensation had been paid under the CSLR.

Senator Pratt asked whether the Law Council had a view about how the scheme pays out determinations against AFCA members that are still operating when it is meant to be a scheme of "last resort".

The FSC does not disagree that ASIC should have the power to apply disciplinary measures in response to a CSLR payment being made, and that it could be appropriate for ASIC to

licence of the AFCA member which was the subject of the "relevant AFCA determination" that led to the compensation being paid under the CSLR.

However, the FSC is of the view that ASIC should have flexibility to determine the appropriate response in particular circumstances. It may well be the case that other ASIC powers can be used to achieve a solution that is more optimal and has less adverse consequences for the affected licensee and third parties (who may have no involvement in the circumstances which caused the "relevant AFCA determination" to be made, such as authorised representatives who are not accused of any wrongdoing).

The FSC would be more comfortable if these provisions required ASIC to "consider whether" to suspend, vary, cancel or impose conditions on a licence or take any other enforcement action, rather than simply state that ASIC "must" cancel the relevant licence in every case. This approach would recognise that the scenarios which result in a payment being made under the CSLR will not always be straightforward or black and white, and that there could potentially be situations where the cancellation of the licence could cause more harm (not necessarily to the affected licensee) than the harm which has been suffered by the consumer to which the compensation payment relates.

Senator Pratt made reference to the "Sterling collapse" at the Hearing and appeared concerned that ASIC had not cancelled the relevant scheme operator's licence. The FSC would caution, firstly, that the operator was responsible for other financial products at the time which had not experienced problems of the same nature as the Sterling product and, secondly, that it is not always safe to generalise or assume that what happened in a particular situation at a particular time is an accurate prediction of how ASIC might deal with future situations.

The FSC does not believe that the retention of some flexibility in ASIC's response would detract from the characterisation of the CSLR as a scheme of "last resort".

The Law Council would welcome the opportunity to discuss the submission further. Please contact Dr Natasha Molt, Director of Policy [redacted] or [redacted] in the first instance, if you require further information or clarification.

Yours sincerely

[redacted]

Margery Nicoll
Acting Chief Executive Officer