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LAWYERS

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The Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Sir

Inquiry into Unfair contract terms

We appreciate the opportunity to make a submission in relation to the *Trade Practices Amendment (Australian Consumer Law) Bill 2009* which received its first reading in the House of Representatives on 24 June 2009 (**ACL Bill**).

Minter Ellison made submissions to Treasury on both its Consultation Paper on the Australian Consumer Law unfair contract terms draft provisions issued on 11 May 2009 and the previous consultation paper entitled *An Australian Consumer Law: Fair Markets - Confident Consumers* issued on 17 February 2009. As noted in previous submissions, we welcome the Government's proposal to implement uniform and consistent consumer protection laws in Australia. Any measure which simplifies the compliance regime for business will produce significant benefits for Australia both in terms of reducing the costs of doing business here and therefore increasing Australia's attractiveness for local and foreign investment, but also for reducing the likelihood of non-compliance which will benefit consumers and businesses alike.

The focus of our previous submissions and this submission is on the implications for the financial services industry. While we recognise that the ACL Bill will have profound consequences for all sectors of the Australian economy, we are particularly concerned that the measures proposed are not appropriate for the financial services sector. Our concerns in this regard are set out in our previous submissions, but we have restated them here for convenience.

Summary

1. We are concerned that the ACL Bill could have serious consequences for the financial services market in Australia and for Australia's attractiveness as a regional financial services centre. Given the comprehensive regulation of financial services already in place in Australia, there is no need for an unfair contract terms regime to apply to financial services. While this may also mean that it is less likely that there will be unfair financial services contracts, the problem is the uncertainty that will result from such a broad ban on

unfair terms and the additional costs that industry will incur when grappling with that uncertainty.

2. Financial services businesses have developed considerable experience and expertise in the application of the successful, robust and comprehensive consumer protection measures which apply to their industry. We submit that it is not appropriate to add to the burden of regulation in this industry in the absence of any demonstrated failure of existing regimes.

3. Furthermore, we note that the regulation of the consumer credit industry is about to be significantly increased if the *National Consumer Credit Protection Bill 2009* (**Credit Bill**) is passed in its current form. The Credit Bill includes significant new consumer protection measures in the form of the proposed responsible lending obligations. We submit that it would be appropriate to allow industry to implement the Credit Bill and to assess its impact on the credit industry before seeking to impose additional untested regulation in the form of the unfair contract terms provisions of the ACL Bill.

4. We acknowledge that the Government has made some significant changes in the ACL Bill and in particular we welcome the decision to restrict the application of the unfair contract terms provisions to consumer contracts. We do not believe that there is any reason for such provisions to apply to contracts between businesses, particularly larger businesses able to look after their own interests or where they have legal representation.

5. Furthermore, the ACL Bill now includes an exemption for constitutions of companies, managed investment schemes and other bodies: clause 12BL(3).[1] While this exemption is welcome, it does not address all of our concerns regarding the application of the proposed unfair contract terms provisions to financial services and products for the reasons set out below.

6. We are also concerned the that the introduction of a new civil penalty and infringement notice regime will make the financial services industry more risk averse and more likely to give undue weight to regulatory guidance which in turn is likely to stifle product innovation.

7. We have set out our concerns in more detail below. We note that while we have considered the position of our clients in the financial services industry in relation to the matters raised in this submission, the views expressed are ours alone.

Regulation of financial services industry

8. The financial services sector is already subject to extensive general law and statutory regulation providing consumer protection, including:

   (a) Chapter 7 of the *Corporations Act 2001* (Cth) in relation to the provision of financial services and products – to extended margin lending facilities under the *Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009* (**Modernisation Bill**);

   (b) Chapter 5C and other provisions of the Corporations Act which regulate the provision and operation of registered managed investment schemes;

[1] All references in this submission to clauses are to clauses of item 7 of Part 1 of Schedule 3 of the ACL Bill, being amendments to the *Australian Securities and Investments Commission Act 2001* (**ASIC Act**), unless otherwise stated.

(c) the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**) which regulates superannuation trustees and funds;

(d) the *Insurance Contract Act 1984* (Cth) which regulates general and life insurance contracts;

(e) the *Uniform Consumer Credit Code* relating to the provision of consumer credit – proposed to be replaced with the *National Credit Code* and the associated Credit Bill which will impose significant licensee and responsible lending obligations;

(f) statutory duties imposed on life insurance companies and their directors under the *Life Insurance Act 1995* (Cth) (**Life Act**);

(g) prudential regulation of banks and other deposit taking institutions and insurance companies under the *Banking Act 1959* (Cth), the *Insurance Act 1973* (Cth) and the Life Act;

(h) the ASX Listing Rules and Market Rules, the ACH Clearing Rules, the ASTC Settlement Rules, the SFE Operating Rules and Clearing Corporation Rules and Austraclear Regulations;

(i) general trust law which imposes significant duties on trustees of superannuation funds and responsible entities of managed investment schemes;

(j) industry standards and codes of practice issued by various industry associations, including the Australian Banking Association, the Financial Planning Association, the Insurance Council of Australia, the Investments Financial Services Association, the National Insurance Brokers Association and the Australian Stock Exchange; and

(k) regulatory guides and policies issued by the Australian Securities and Investments Commission (**ASIC**).

9. We do not believe therefore that there is any need for the unfair contract terms provisions of the ACL Bill to apply to the financial services sector. We have set out our specific concerns below.

Credit reform

10. As noted above, the Credit Bill proposes to make very significant changes to the provision of credit in Australia. The Government has also stated that the Bill is only phase 1 of the credit reform process and that phase 2 will involve further changes to the regulation of credit activities in Australia.[2] We submit that any consideration of whether an unfair contract terms regime should apply to the credit industry should be undertaken as part of this process. The credit industry is already subject to significant change and any further change of this magnitude should be done on a measured and fully considered basis.

[2] Joint Media Release of the Prime Minister and Assistant Treasurer and Minister for Competition Policy & Consumer Affairs, *New Measures for Australian Financial Services* (3 October 2008).

Managed investments

11. We note that the ACL Bill now includes an exemption for constitutions of companies, managed investment schemes and other bodies in proposed clause 12BL(3) of the ASIC Act. This exemption will address concerns in relation to managed investment schemes and companies, but only to the extent that those concerns derive from obligations arising under the constitution of the scheme or company. It does not address concerns that other conduct relating to a company or managed investment scheme may give rise to a contract between the member and issuer.

12. In particular, there is a significant body of thought that a product disclosure statement for a managed investment scheme may, together with the scheme constitution, give rise to a contract between a member and the responsible entity which arises when the prospective member applies to invest in the scheme by completing the application form which accompanies the product disclosure statement.[3] We note that similar concerns arise for superannuation funds as well.

13. The question whether a contract exists between the member and the trustee or responsible entity in addition to their rights as a beneficiary under trust law has not been finally resolved. It has some significance when trying to determine the extent to which rights of trustees and responsible entities can be supplemented by statements in the product disclosure statement. The question has not needed to be resolved to date because any question relating to rights of members that could be answered by reference to contract law can typically be answered by reference to existing consumer protection law, principally the prohibition on misleading or deceptive conduct. However, the application of unfair contracts regulation may mean that the courts will need to grapple with this question and in the meantime product issuers will face considerable uncertainty whether the regime applies to them.

14. Product disclosure statements are subject to rigorous regulation under Division 3 of Part 7.9 of the Corporations Act which, among other things requires them to:

- include information about certain topics, including significant benefits, risks and terms and conditions;
- include any other information that a client would reasonably need to decide whether to invest in the product; and
- be clear, concise and effective.[4]

15. The Corporations Act imposes significant penalties for failure to comply with these obligations and makes issuers and others liable for any misleading or deceptive statements in product disclosure statements.[5] Similar obligations apply to issuers of prospectuses.[6] We do not believe that it is necessary to impose any additional obligations or penalties on issuers of managed investment products or securities or for that matter issuers of other products requiring a product disclosure statement, including superannuation, life and general insurance and derivatives.

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[3] For example, Basis Capital contended in the case of *Basis Capital Funds Management Ltd v BT Portfolio Services Ltd* [2008] NSWSC 766 that the completed application form and Basis Capital's confirmation letter together constituted a binding contract on the terms of the constitution and product disclosure statement for the fund in question. Austen J agreed that the application form and confirmation constituted a binding contract: para 98-101.
[4] Corporations Act, ss 1013C-1013E.
[5] Corporations Act, Part 7.9, Div 7.
[6] Corporations Act, Ch 6D.

Submission

16. We therefore submit that the exemption in clause 12BL(3) should be amended to address these concerns. This could be achieved by making the following amendment in addition to the other amendments suggested in this submission:

    - add the following words at the end of clause 12BL(3):

      'or that results either partly[7] or wholly from statements made in a product disclosure statement.'

Superannuation funds

17. It is also unclear whether the proposed exemption in clause 12BL(3) is intended to apply to other financial products, such as superannuation funds.[8] There are significant similarities between the regulation of superannuation funds and managed investment schemes:

    - there is a trust relationship between the fund trustee and fund members;
    - superannuation trustees are required to hold an RSE licence issued by the Australian Prudential Regulation Authority (**APRA**) under the SIS Act[9] to operate the fund; and
    - the governing rules of superannuation funds are regulated by the SIS Act.

18. The proposed exemption in clause 12BL applies to *'the constitution of … other kind of body.'* While it could be argued that the governing rules or trust deed of a superannuation fund is a 'constitution', a superannuation trust deed is not normally known as a constitution which, apart from its legislative use in relation to managed investment schemes, is a term usually used for the constituent arrangements of bodies such as companies, associations and clubs rather than trust arrangements. Furthermore, it is not at all clear that a superannuation fund would be a 'body'. The term 'body' is defined in the Corporations Act as[10] as *'a body corporate or an unincorporated body and includes, for example, a society or association'.* It does not refer to a trust fund or scheme. Given the separate regulation of schemes under the Corporations Act, this suggests that managed investment schemes are not bodies for the purposes of that Act. As superannuation funds would be managed investment schemes but for their exclusion from the definition of managed investment scheme,[11] this in turn suggests that superannuation funds are not bodies under the Corporations Act or therefore the ASIC either.

[7] A contract will only be partly referrable to the product disclosure statement where it is also referrable to the constitution or governing rules of a managed investment scheme or superannuation fund or the application form for a product.
[8] The Explanatory Memorandum does not provide any indication whether superannuation funds should be able to rely on this exemption.
[9] Responsible entities are required to hold a licence to operate a registered scheme issued by ASIC under the Corporations Act.
[10] Corporations Act, s 9. The ASIC Act does not define 'body' but provides that terms defined in the Corporations Act have the same meaning in the ASIC Act as they do in the Corporations Act: ASIC Act, s5(2).
[11] Corporations Act, s9, definition of 'managed investment scheme', para (h).

Submission

19. We therefore submit that the exemption in clause 12BL(3) should be amended to address these concerns. In addition to the other amendments suggested in this submission, this could be achieved by making the following amendments:

- after *'constitution'* add *', governing rules or trust deed'*;
- after *'scheme'* add *', superannuation entity'*; and
- after *'body'* add *'or scheme'*.

20. This approach is consistent with the fiduciary and equitable duties which apply equally to trustees of superannuation funds as they do to responsible entities of managed investment schemes. There are also specific statutory duties applying under the SIS Act, including covenants which are implied into superannuation fund trust deeds requiring trustees and their directors to act honestly and in the best interests of members (section 52). The SIS Act also regulates the terms of constituent documents for superannuation funds and impose various restrictions in the way superannuation trustees deal with members.

Insurance contracts

21. We are concerned about the potential application of the unfair contract terms provisions to insurance contracts. We note that section 15 of the Insurance Contracts Act relevantly provides that an insurance contract is not capable of relief under any other law relating to harsh, oppressive, unconscionable, unjust, unfair or inequitable conduct by an insurer, **other than** relief in the form of compensatory damages. The reference to compensatory damages in the exception to section 15 means that there is some scope for the unfair contract terms provisions to apply to insurance contracts.

22. We note that the Government has sought to address this by including a comment in the Explanatory Memorandum to say that the effect of section 15 is *'to mean that the unfair contract terms provisions of either the ACL or the ASIC Act do not apply to contracts of insurance covered by the Insurance Contracts Act 1984'*.[12] While the Government includes a reference to the compensatory damages exclusion, it does not address it.

23. We note that it is appropriate to exclude insurance contracts given the following:

(a) a duty of utmost good faith applies to insurance contracts (under the general law and Part II of the Insurance Contracts Act);

(b) restrictions on the remedies of insurers for non-disclosure and misrepresentation by insureds in relation to insurance contracts (Division 3 of Part III of the Insurance Contracts Act);

(c) various provisions relating to terms of insurance contracts (Part V of the Insurance Contracts Act);

(d) restrictions on expiration, renewal and cancellation of insurance contracts (Part VII of the Insurance Contracts Act);

(e) restrictions in relation to credit-related insurance contracts (Part 8 of the Consumer Credit Code).

[12] Para 2.100.

24. As we believe that compensatory damages could be claimed by a consumer in relation to a provision of an insurance contract is void for unfairness under clause 12BF, there is a real risk that the unfair contract terms provisions will apply to insurance contracts. If, as appears to be the case based on the Explanatory Memorandum, the Government does not intend that these provisions should apply to insurance contracts then there is no reason not to include an express exclusion to that effect in clause 12BL.

25. A statement in the Explanatory Memorandum can only assist in the interpretation of a provision, it does not change the law. In our view, there is nothing in the ACL Bill which would entitle a court to have regard to the statement in the Explanatory Memorandum on the effect of section 15 and even if a court did have regard to it the failure of the statement to address compensatory damages means that it is unlikely to be relevant.

Submission

26. We therefore submit that an express exclusion of insurance should be made to remove any doubt (and unnecessary expense for both insurers and consumers).

Other financial products and services

27. The amendments set out above in relation to clause 12BL would address concerns in relation to the following products:

- superannuation products;
- interests in managed investment schemes;
- life policies which are insurance contracts;
- general insurance policies; and
- shares.

28. However, concerns would still remain in respect of other financial products and services, including:

- life policies which are not insurance contracts, such as investment account and investment linked contracts and fixed term annuities;
- other securities, such as debentures;
- listed products other than shares, including options and warrants;
- agreements with Australian financial services licensees and their representatives or ASX market participants;
- deposit products, retirement savings accounts and first home saver accounts provided by an authorised deposit-taking institution (ADI);
- credit facilities to be regulated by the Credit Bill;
- margin lending facilities to be regulated as financial products under the Modernisation Bill; and
- other similarly regulated financial products.

29. We do not believe that the unfair contract terms provision needs apply to these products and services given the high level of regulation and supervision by ASIC and other regulators such as APRA and the ASX already in place. Examples of specific requirements applying to financial services and products include:

(a) various conduct and disclosure requirements apply to financial service providers and issuers of financial products – these include:

(i) for financial service providers – financial service guides, the requirement to have a reasonable basis for personal advice, statements of advice, general advice warnings, trust account obligations, and hawking prohibitions and regulation (Parts 7.7 and 7.8 of the Corporations Act);

(ii) for product issuers – product disclosure statements, application form and application money requirements, transaction confirmations, periodic reporting, significant event reporting or continuous disclosure, other information on request, hawking prohibitions and regulation, and cooling off (Parts 7.8 and 7.9 of the Corporations Act);

(iii) for all financial services licensees – general obligations such as the obligation to provide financial services honestly, efficiently and fairly, to have appropriate complaints handling, compensation and conflict management procedures, and to have appropriate compliance procedures, including procedures to train, monitor and supervise representatives (sections 912A and 912B of the Corporations Act);

(b) regulation of consumer credit contracts under the Consumer Credit Code (to be replaced and upgraded by the National Credit Code as part of the Credit Bill);

(c) directors of life insurance companies are required to give priority to the interests of policy holders ahead of shareholders (Division 2 of Part 4 of the Life Act);

(d) debentures offered to retail clients are required to have a security trustee to protect their interests and offers may only be made under a prospectus (Chapters 2L and 6D of the Corporations Act; the Modernisation Bill proposes to amend the definition of 'debenture' to expand the reach of these obligations);

(e) issuers of listed products are required to comply with ASX Listing Rules;

(f) ASX and SFE participants are required to comply with the ASX Market Rules, the ACH Clearing Rules, the ASTC Settlement Rules and the SFE Operating Rules, as appropriate to the nature of their business.

30. We therefore believe that financial services and products are already appropriately regulated and consumers of financial services and products already have many remedies available to address any instance where a financial service provider might deal with them unfairly. Subjecting financial service providers to additional unfair contract terms regulation would simply create uncertainty for the industry with little or no resulting consumer protection benefit.

National consistency

31. The Explanatory Memorandum notes that the Productivity Commission was of the view that the strongest argument for the inclusion of an unfair contracts provision in the ACL Bill is to maintain national consistency.[13] However, the regulation of unfair contracts in Victoria does not in fact have much if any application to financial products or services. This is because section 1041I of the Corporations Act excludes State and Territory laws from applying to any conduct relating to any product disclosure statement, prospectus, takeover document, financial services guide or statement of advice. As a result of this exclusion, it is very rare for State and Territory regulators to take any action in relation to

[13] Para 11.74.

financial services. It is our understanding that any such action would typically be referred to ASIC.

32. The exclusion in section 1041I reflects the legislative policy at the time of its enactment that the comprehensive regime of financial services regulation both under the Corporations Act and other Federal legislation means that other measures, including any unfair contracts regulation, should not apply to financial services and products. We submit that this remains true today and that a more appropriate and nationally consistent outcome would be to exclude the operation of the unfair contract terms provisions of the ACL Bill in relation to financial services and products. This could be achieved simply by retaining clause 131 of the proposed amendments to the Trade Practices Act 1974 in item 11 of Part 2 of Schedule 1 of the ACL Bill and removing Part 1 of Schedule 3 from the ACL Bill.

Compliance cost

33. The Explanatory Memorandum also notes that:

(a) evidence from the implementation of the unfair contract terms legislation in Victoria and elsewhere is that compliance costs for businesses are not likely be significant;[14] and

(b) business will have 'Low compliance costs associated with re-examining standard form contracts'.[15]

34. We believe, however, that imposing such regulation on financial services businesses will have a significant impact on the way that they manage their business.

35. Financial service providers are already required to have robust internal complaints systems and to participate in independent external complaints handling bodies. These measures ensure that the financial services industry meets its extensive obligations to clients. They can also create uncertainty for issuers as external complaints handling bodies tend to be outcome oriented when resolving complaints rather than necessarily applying the strict letter of the law. The addition of a new broad unfair contract terms remedy will obviously increase this tendency.

36. While this outcome may sound attractive from a consumer perspective, what it means in practice is that businesses will be more likely to concede complaints without regard to fault. This in turn is likely to reduce product innovation and increase costs of doing business. It is important to recognise that all consumers pay through increased fees and charges for costs incurred by businesses to comply with regulatory requirements which increase with the level of uncertainty regarding the application of those requirements. The broad nature of the unfair contract terms remedy is therefore likely to significantly increase the cost of doing business in the financial services sector in the long-run.

37. We also note that any review of existing product terms to determine whether they are 'unfair' is likely to be an expensive process repeated across every business in the sector. A review of this nature takes a significant amount of time requiring specialist resources and advice. We do not therefore believe that the Committee should accept the assertions of the Government in the Explanatory Memorandum in relation to cost of implementation. The cost is likely to be high: in dollar terms; in the amount of time spent by management

[14] Para 11.71.
[15] Ch 11, Table: Option C – Modified PC model, p 137.

and product, legal and compliance staff; and in relation to long-term efficiency and innovation of the financial services sector in Australia.

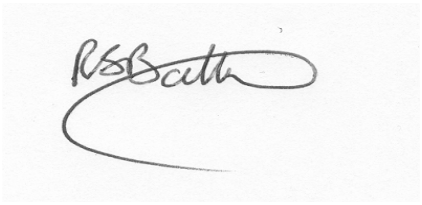
Civil penalties and infringement notices

38. We note that the Government believes that imposing criminal sanctions for breaches of the licensing regime can result in an overly cautious approach by businesses to compliance, which can stifle innovative approaches which would otherwise be desirable to encourage while lower level breaches persist because of the difficulty of prosecution.[16] While we acknowledge these concerns, we believe there is a real risk that the lower standard of proof and the ability of ASIC to impose infringement notices without going to court will do significantly more to create a risk adverse culture amongst regulated businesses. We are concerned that a lower standard of proof will mean that ASIC will be more inclined to prosecute breaches. The infringement notice power certainly seems likely to lead to more aggressive enforcement by ASIC.

39. We do not believe that aggressive enforcement is normally the best recipe to encourage businesses to weigh appropriately the risk of non compliance against conducting their business in a cost effective and efficient manner to reduce their costs and to manage their risks in a way that is ultimately to the benefit of consumers. We submit that the Committee should give serious consideration to the appropriateness of civil penalty regimes and in particular infringement notice powers and the potentially negative consequences that these sorts of powers and penalties could have in a commercial environment.

We would be very happy to respond to any enquiries the Committee may have in relation to our submission.

Yours faithfully
MINTER ELLISON



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[16] Explanatory Memorandum, paras 9.34 – 9.35.