K&L GATES

Financial Systems Inquiry Submission

31 MARCH 2014

Dear Financial Systems Inquiry

Complexity of Regulation, Australian Fund Structures & Dedicated Privacy Regulator

1. Complexity of Regulation

1.1. The law governing financial services has become excessively complex and technical - a propagation of statute, regulations and legislative instruments have obscured the law, increased the risk of mistakes in applying the law and exacerbated the compliance burden. Regulator overlaps, inconsistencies in enforcement and successive regulatory modifications have lead to pervasive uncertainty in the financial services industry. A rationalisation and consolidation of financial services regulation would benefit consumers, industry and the Australian economy at large.

1.2. The most over-used and misapplied legislative instruments are ASIC Class Orders and ASIC Regulatory Guides. Both have been utilised to create entirely novel regulatory regimes for specific categories of financial products and financial service providers. The resultant regulatory framework is often one neither contemplated by, nor evident upon the face of, the primary legislation. For instance, certain ASIC Class Orders have the effect of varying AFS licence conditions from how they are prescribed under the Corporations Act 2001 (Cth). ASIC Class Orders and Regulatory Guides have distorted and glutted financial services regulation.

2. Australian Fund Structures

2.1. We consider that the current regulation of companies and trusts in Australia hinders this country's ability to remain competitive in the international funds management industry and acts as a major obstacle to Australia consolidating its position as a leading international financial center. There is no mandated legal structure for funds in Australia. Funds are structured as unit trusts due to the accompanying tax advantages of such a structure, specifically funds will not incur any tax on the profits it distributes to unitholders, rather the unitholders will pay income tax on the profits they receive from the fund.

2.2. The regulation and operation of companies under the Corporations Act is insufficiently flexible to provide any incentive for Australian funds to be structured as a company. In our view, this is a distinct disadvantage for Australian fund managers who are now competing in an increasingly global marketplace populated by fund managers that are able to offer investors multiple investment vehicles in a variety of different legal structures.

2.3. We consider that it is imperative that the necessary reforms to the Corporations Act be made in order to allow for funds to be set up in Australia as either companies or unit trusts. We are of the view that any delay in considering this issue would be highly detrimental to the Australian funds management industry as it would fall further behind the other international financial centers in terms of attracting more global asset managers to domicile funds in the Australian market.

2.4. It is worth noting the recent developments in Hong Kong as evidence of the need for change. On 27 February 2013, the Financial Secretary of Hong Kong announced that it was considering legislative amendments to introduce the Open-ended Investment Company as an alternative structure in its market. The justification for this proposed reform was as follows:

> "At present, investment funds established in Hong Kong can only take the form of trusts. As an international financial centre, Hong Kong should provide a more flexible business environment for the industry to meet market demand. To attract more traditional mutual funds and hedge funds to domicile in Hong Kong, we are considering legislative amendments to introduce the Open-ended Investment Company, an increasingly popular form used in the fund industry."[1]

2.5. We strongly support the implementation of similar reforms in Australia and note that the above justifications would equally apply.

3. Dedicated Privacy Regulator or External Dispute Resolution Scheme

3.1. In recent years, the financial services industry has witnessed an exponential increase in the amount of customer personal information that it is expected to collect and retain. Stringent risk and compliance frameworks, increased disclosure obligations and the progressive shift towards electronic data records, among other factors, have contributed to a proliferation of customer personal information collection.

3.2. The Privacy Commissioner has recently been bestowed with new powers to enforce the Australian Privacy Principles (APPs), covering the enhanced rights of individuals in relation to how their information is collected, stored, used and disclosed. The introduction of external dispute resolution (EDR), a customer dispute resolution mechanism with proven success in the banking context, is a particularly significant development in privacy law.

3.3. However, there are concerns within the financial services industry that the Privacy Commissioner lacks the adequate capacity to fully enforce the new obligations given the sheer scale of data breaches, when they occur, and the volume of client data associated with the financial services industry. Considering the gargantuan and specialised nature of such a task, the financial services industry may require a dedicated privacy regulator or external dispute resolution scheme.

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[1] 2013-14 Budget (available at: http://www.budget.gov.hk/2013/eng/budget07.html).

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