30 June 2023

David Pearl
Assistant Secretary
Competition and Consumer Branch
Markets Group
The Treasury
Parkes ACT

By email: david.pearl@treasury.com.au

Dear Mr Pearl

Unfair Contract Terms Small Business Extension
Unintended Impact on Institutional Financial Market Contracts

The Australian Financial Markets Association (AFMA) is writing to you about the *Treasury Laws Amendment (More Competition, Better Prices) Act 2022* (UCT Reforms) that is due to come into effect on 9 November 2023. We wish to raise urgent concerns with respect to its application to institutional and financial market contracts in ways which we believe are not intended by the Government. This letter describes the problem and the need to find a solution. We suggest it would be consistent with the intention of the UCT Reforms and the regulatory approach in the *Australian Securities and Investments Commission Act 2001 (*ASIC Act), the *Corporations Act 2001* (Corporations Act) for the UCT regime to be adjusted to ensure its application does not extend to certain specified markets contracts or contracts with wholesale investors as a party.

AFMA represents the interests of over 120 participants in Australia's financial markets. Our members include Australian and foreign owned banks, securities companies, treasury corporations, traders across a wide range of markets and industry service providers. They are the major providers of wholesale banking and financial market services to Australian businesses and investors.

1. Issues

In summary, from a financial markets contract perspective, the amendments that will be made to the unfair contract terms (UCT) provisions in the ASIC Act (UCT provisions) through the UCT Reforms raise concerns in relation to:

1. (**Small Business Definition**): the expanded small business definition captures many types of 'big business';
2. (**Upfront Price**): the upfront price concept (contracts over $5m being excluded) being unclear in its application to many contracts and ineffective to ensure the scope of the regime is appropriately limited to true small business contracts;
3. (**Standardisation**): the use of template industry contracts which underpin liquidity, speed and certainty of execution and global standardisation in certain markets not being specifically catered for in the regime (given the expanded definition of small business draws in so many industry players) also inhouse templates (ie not just industry templates) which are used as a starting point for negotiation with customers. A portfolio of executed agreements based on such templates may look quite similar, even though they are able to be negotiated, but the presumption makes it risky to not treat these agreements as 'standard form';
4. (**Grandfathering**): the grandfathering provisions can be difficult to apply to master agreements (which by their terms can unexpectedly bring the whole agreement into the regime upon entry into any new trade); and
5. (**Geographic Application**): there is a risk the new regime applies where the only nexus with Australia is that one of the parties to the agreement conducts business in Australia – the entire transaction, documentation, domicile of the parties and location of the persons involved could be outside Australia.

Of these the expanded definition of small business is the key issue, which if addressed could mitigate the impact of the other concerns. This expanded definition will see the legislation applied to a 'standard form contract' to which either party (whether the financier or customer) has under 100 employees (FTE). It is clear in reading the Explanatory Memorandum and Regulation Impact Statement for the UCT Reforms that this was not an intended policy objective. Rather, the UCT Reforms are meant to address situations where "*Consumers and small businesses generally lack the resources and bargaining power to effectively review and negotiate contract terms or challenge their enforcement*".[1] This is not the case where professional or sophisticated financial market participants enter into contracts with each other (often on standard forms to meet market expectations rather than as a result of resourcing or bargaining power of either party).

1.1. Application of small business test

The definition of "small business contract" has been expanded to include a contract, within certain value thresholds, with any entity with less than 100 employees or less than $10 million annual turnover. In relation to the number of employees, many large corporate groups have a single subsidiary for employment purposes, which often results in other subsidiaries and the ultimate parent company having few or no employees. Under the new definition of "small business contract", a standard form contract entered into with a non-employing subsidiary or a non-operating head company would be subject to the new provisions. For example, a counterparty could enter into a standard form contract with a non-employing subsidiary of a major Australian financial institution or ASX100 company, and suddenly be caught by this legislation. Hedge funds, both on and

[1] Regulation Impact Statement, UCT Reforms.

off balance sheet special purpose vehicles (eg holding title to aircraft or office buildings), investment managers, trustees and custodians are all potentially caught based on their number of employees alone as the expanded definition fails to take into account their status within a corporate group more generally. This clearly cannot be the legislative intent.

In relation to the $10 million annual turnover, many entities may have more than an annual turnover of $10 million but because they have less than the specified number of employees, they are still regarded as a small business. This means that listed entities, entities that hold financial services licences or entities who are regulated by the Australian Prudential Regulation Authority (APRA), to name a few, can all receive the protection of the UCT Regime, even though the market would not treat these entities as consumers or small businesses who "generally lack the resources and bargaining power to effectively review and negotiate contract terms or challenge their enforcement". Similarly, the turnover test may not accurately reflect the size of an organisation where the contracting entity itself has lower turnover but is part of a much larger group.

1.2. Application of Upfront Price Exemption

It may have been expected by the drafters of the UCT Reforms that the value threshold of only applying to contracts for less than $5 million would exempt larger value financial market contracts entered into with more sophisticated small businesses. However, the consideration involved which can be determined as at the execution date may often be for a much lower amount when entering counterparty arrangements. The value of ensuing financial transactions may be for large sums but which are contingent at the time the contract is entered into or not clearly determinable so the exemption does not apply (loan commitments, options, best endeavours underwrites). Similarly many relationship agreements have no upfront price when entered into (ISDA Master Agreements, prime brokerage and repurchase/stock lending arrangements) and the exemption does not clearly apply). In addition, many counterparties in financial markets enter into a stream of small value but frequent repeat transactions which would add up to well over $5 million in aggregate but would not be outside the scope of the UCT Reforms.

1.3. Extraterritorial application of UCT Reforms

Section 4 of the ASIC Act provides that the ASIC Act applies in the jurisdiction, however section 12AC of the ASIC Act extends the application of the consumer protection division in relation to financial services to some conduct outside of Australia. Subsection (1) provides that the division extends to the engaging in conduct outside of Australia by bodies corporate incorporated or carrying on business within Australia. This means that where an Australian incorporated entity (for example a branch of an Australian bank in London) carries on business outside of Australia, then the UTC Reforms will apply. Therefore standard form contracts used by Australian entities through their branches in other jurisdictions on terms considered market standard in those jurisdictions with no other connection to Australia will be subject to the UCT Reforms. This will place pressure on those branches to have all their standard templates reviewed, when they are likely already subject to the laws of the jurisdiction in which they operate. It may also be that foreign incorporated entities who do business in Australia would be caught by UCT if they enter into a small business contract even wholly outside Australia: all parties could be resident outside Australia, all aspects of the transation could be outside Australia, but there seems some risk the UCT regime could still apply.

2. Evolution of UCT provisions and impact on institutional financial markets

When considering the policy issue we have raised it is worth bearing in mind the legislative evolution of the UCT provisions which have inadvertently led to the current problematic situation.

- **Original extension to cover small business contracts:** In the Explanatory Memorandum to the *Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Bill 2015* (2015 Bill), the Government noted that the reason for the extension of the UCT protections to cover small business contracts was to address the vulnerable position that small businesses may be in by allowing UCT to be declared void, providing a remedy for small businesses.[2] It was noted that this was to reduce the incentive for counterparties to include and enforce UCT in small business contracts, providing for a more efficient allocation of risk in these contracts and supporting small business' confidence in agreeing to contracts.[3] The emphasis was on 'small' business.
- **Desire not to adversely impact institutional financial markets:** During the 2014-15 consultation process on the 2015 Bill, AFMA warned in its submission that while the extension of the UCT protections to small businesses should achieve the objective of protecting genuine small businesses from UCT there needed to be a mechanism to ensure this part of the law would not intrude in the future into the institutional financial market space, where standard terms are commonly used in contracts relied upon to ensure market consistency and fairness. As a result, the current legislation includes a regulation making power in Section 12BL (2) of the ASIC Act allowing a small business contract to which a prescribed law of the Commonwealth, a State or a Territory applies, to be exempted out of application under the 'standard form contract' provisions.
- **Further extension of UCT provisions:** There was a consultation process in 2021 in respect of the *Treasury Laws Amendment (Measures for A Later Sitting) Bill 2021: Unfair Contract Terms Reforms.* AFMA noted to Treasury at the time that there needed to continue to be a mechanism so that any UCT-related reforms would not intrude into the institutional financial market space. At that time, the full impact of the UCT Reforms on institutional financial markets was not fully analysed and assessed. As you may appreciate this is a big exercise that the industry had to conduct among many other financial market reform priorities.

Since the UCT Reforms were passed on 27 October 2022, financial market participants have been seeking legal advice and conducting contract reviews to prepare for the implementation in November this year. The exercise determining which standard form contracts and which customers are within scope under the revised definition of small

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2 Explanatory Memorandum to the 2015 Bill, [1.6].
3 Ibid.

business has now highlighted previously anticipated concerns as set out in section 1 of this letter.

3. Regulatory Impact

The institutional financial markets commonly rely on a wide range of 'standard form contracts' that will be unintentionally subject to the UCT Reforms.

3.1. Examples

In the ***Attachment*** to this letter we set out examples of standard form contracts that will most likely be caught by the UCT Reforms which are almost always contracts between professional investors in the institutional financial markets space.

The institutional financial markets commonly rely on a wide range of 'standard form contracts'. Major examples that have been identified as being likely in scope are standard form contracting documentation in the repurchase and securities lending space. These are very large markets measured by gross notionals which serve a vital economic need in providing securities as collateral for transactions to allow for better liquidity in the financial markets. Forcing participants out of the market because they could be deemed to be a 'small business' is a risk introduced by the UCT Reforms.

Other areas that are being identified lie in the capital raising area. Here the type of contractual terms that may be in scope can be found in: online 'Roadshow acknowledgments and agreements; data room click through acknowledgments and agreements; access to research reports through a website that is subject to a terms of use process; industry standard documents drafted and adopted to expressly facilitate and respond to the short timeframes on capital markets transaction such as master terms and confirmation letters, co-manager letters and co-Lead Manager letters; standard disclaimers for models and other material in presentations; and vendor usages of block trade agreements used in 'beauty parades'. Much of this type of contractual documentation is used in cross-border transactions and meets international norms and expectations.

The terms and conditions provided in standard form institutional market documentation have been developed over many years to accord with best risk management practice, global norms, liquidity considerations (for secondary trading and fundraising against portfolios etc) and both statutory and case law. Often, standard form contracts are used as a necessity to ensure that transactions can occur on an expedited timetable (for example, placements or the institutional component of an accelerated entitlement offer). Where sometimes they may appear to provide a favourable one-sided position to one party against another, the terms have been drafted this way for market driven reasons.

3.2. Effect

While historically a UCT was merely voidable by a court, the UCT Reforms introduce penalties which completely change the compliance risk profile. The civil penalty regime in the ASIC Act will apply to making a contract with a UCT even if that provision is never enforced. There is a separate contravention for each UCT.

Overall, this change will make it more costly and more legally risky to serve Australian counterparties. It could adversely affect the ability of Australian parties to provide or receive related financial services offshore, and potentially increase costs of getting such services or in the worst case make it impossible to transact in Australia which could, among other things, prevent the efficient and safe re-allocation of risk via intermediation in local and offshore markets.

Furthermore, AFMA is concerned about how the UCT Reforms might be used and misused by those that while falling within the new definition of 'small business' are actually a big business, which is not what the Government was intending. The UCT Reforms create an unintended area of legal uncertainty, which is not aligned with legal requirements for safe and efficient financial markets.

4. Solving the problem

As always there may be several avenues to consider for addressing these concerns, which we would be happy to explore with you. In particular, we have a suggestion below that is within the scope of the law without a requirement for legislative amendment and which is consistent with the policy of intention of the UCT Reforms.

There is a mechanism by which this might be done through subsection 12BL(2) of the *Australian and Securities and Investments Commission Act 2001.* Subsection 12BL(2) can enable the prescribing of a 'standard form contract'. This could be a standard form contract that is entered into with a class of institutional clients in the financial markets, who should not be treated as a 'small business'. The existing law provides avenues for identifying classes of persons. 761G of the Corporations Act provides for the distinction between retail and 'wholesale clients'. One solution could be to simply exempt contracts with 'wholesale clients', which includes several thresholds for distinguishing them from retail clients. The Corporations Act includes many provisions distinguishing between wholesale clients (including sophisticated and professional investors) and retail clients, and in doing so, acknowledges the protection that retail clients require as opposed to wholesale clients. This distinction is already important in protections available to participants in the financial markets in a number of areas. Even the Banking Code of Practice acknowledges this important distinction and carves out the application of the BCoP provisions to (i) shares, bonds and other securities issued by a bank; and (ii) financial products and financial services for the purposes of Chapter 7 of the Corporations Act 2001, if you are a 'wholesale client' rather than a 'retail client' (unless you are a wholesale client only because of section 761G(7)(b)).

There is also a definition of 'professional investor' in section 9 of the *Corporations Act*. Based on the compliance regimes already operating in markets related documentation and related disclosure requirements, we suggest Treasury consider carving out contracts with 'wholesale investors' from the UCT Reforms. This would limit the impact of the changes to contracts which 'small business' in the traditional sense.

The concept of exempting a standard form contract with a 'wholesale investor' is compatible with idea of protecting contractual relationships with small business as intended by the law.

5. Next steps

We have recently advised the Financial System Division as part of our regular liaison meetings with them of our intention to raise this issue with you and they are aware in general terms of our concerns and the nature of the issue. AFMA would be pleased to arrange discussion with members, including our partner member law firms to discuss this problem, including engaging with ASIC to exercise its discretionary powers to grant relief by exemption or declaration. Please contact David Love either on 02 9776 7995 or by email dlove@afma.com.au in regard to this letter.

Yours sincerely

David Love
General Counsel

Attachment

Examples of standard form contracts that may be caught by the UCT Reforms which are almost always contracts between wholesale investors in the institutional financial markets space:

Nature of contract	Value of transaction vs. 'upfront price'	Reason why contract is standard form vs. being characterised as individually contracted	Typical counterparties	Impact on market participants / market in general / market confidence / legal uncertainty / costs if cannot be used
ISDA Master Agreements and AMSLA, GMSLA, GMRA Master Agreements for stock lending and other OTC transactions	The upfront price is typically not ascertainable at the time of entering into the contract, which is a relationship document setting out terms on which trades may be undertaken	These agreements are often considered standard form unless there has been "more than insubstantial variations" to the standard terms which might otherwise have been habitually used by a party. This is especially the case once the UCT Reforms introduce a new factor giving rise to a presumption of standard form (being where contracts ultimately urn out the same even where parties had a chance to negotiate)	Various counterparties including individual wholesale investors, AFSL holders, SPVs, SPEs and trustees, hedge funds, resource companies, banks, NBFIs, treasury vehicles etc.	Where each contract needs to be tailored to ensure all provisions are reasonably necessary to meet the dealer's legitimate are likely to create delays, lack of liquidity, operational and basis risks where documentation cannot be standardised for all customers
Securitisation Agreements Security Documents	The upfront price is typically not ascertainable at the time of entering into the contract, which is a relationship document setting out terms on which trades may be undertaken.	These agreements are often considered standard form unless there has been "more than insubstantial variations" to the standard terms which might otherwise have been habitually used by a party.	Various counterparties including individual wholesale investors, AFSL holders, SPVs, SPEs and trustees, hedge funds, resource companies, banks, NBFIs, treasury vehicles etc.	Where each contract needs to be tailored to ensure all provisions are reasonably necessary to meet the dealer's legitimate are likely to create delays, lack of liquidity, operational and basis risks where documentation cannot be standardised for all customers
Trade finance documentation Letters of credit	The upfront price is typically not ascertainable at the time of entering into the contract, which is a relationship document setting out terms on	These agreements are often considered standard form unless there has been "more than insubstantial variations" to the standard terms which might otherwise have been habitually used by a party.	Large import / export companies, such as vehicle manufacturers	Where each contract needs to be tailored to ensure all provisions are reasonably necessary to meet the dealer's legitimate are likely to create delays, lack of liquidity, operational and basis risks where

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	which trades may be undertaken.			documentation cannot be standardised for all customers.
Equity capital markets documentation • Master ECM Terms • Co-manager agreements • Institutional / broker firm confirmation letters • Sub-underwriting letters • Non-disclosure agreements	The upfront price may not always be ascertainable at the time of entering into the contract (e.g. co-manager agreements and sub-underwriting letters may set out The basis for calculating fees but it will depend on other factors, such as final allocations, to determine the fees payable).	The Master ECM Terms are industry standard terms which numerous equity capital markets documents adopt (including co-manager agreements, confirmation letters and sub-underwriting letters). This allows Investors to understand what the terms will be for most deals, minimising the internal approvals they may need in order to participate and the need for negotiation on a deal-by-deal basis. This facilitates the fast pace of ECM transactions.	Various counterparties including individual wholesale investors, AFSL holders, SPVs, SPEs and trustees, hedge funds, resource companies, Banks, NBFIs, Treasury vehicles etc.	Equity capital markets transactions often happen at a very fast pace involving dozens or hundreds of investors – for example, institutional components may be open for 12 to 18 hours only, before allocations are made and institutional / Broker firm confirmation are sent to participating investors. It would not be commercially feasible to negotiate this individually with each investor given the delays this would cause and the expenses associated with it. The market may also move away from the agreed offer price before these letters had been properly negotiated and entered into, creating heightened underwriting risk.
Debt capital markets documentation • Trust Deeds • Bonds/Notes • Non-disclosure agreements • Mandate letters	The upfront price may not always be ascertainable at the time of entering into the contract (e.g. joint lead manager agreements may set out the basis for calculating fees but it will depend on other factors, such as final allocations, to determine the fees payable).	Stardardised agreements allow Investors to understand what the terms will be for most deals, minimising the internal approvals they may need in order to participate and the need for negotiation on a deal-by-deal basis. This facilitates the fast pace of DCM transactions.	Various counterparties including individual wholesale investors, AFSL holders, SPVs, SPEs and trustees, hedge funds, resource companies, Banks, NBFIs, Treasury vehicles etc.	Debt capital market transactionsoften happen at a very fast pace involving many investors. It would not be commercially feasible to negotiate this individually with each investor given the delays this would cause and the expenses associated with it.
Environmental Products Contracts:	The upfront price is typically not ascertainable at the time of entering into the contract,	These agreements are often considered standard form unless there has been "more than insubstantial	Energy supply companies Energy aggregators	Where each contract needs to be tailored to ensure all provisions are reasonably necessary to meet the dealer's legitimate

Nature of contract	Value of transaction vs. 'upfront price'	Reason why contract is standard form vs. being characterised as individually contracted	Typical counterparties	Impact on market participants / market in general / market confidence / legal uncertainty / costs if cannot be used
• Carbon Credit Contract • Environmental Products Addendum	which is a relationship document setting out terms on which trades may be undertaken.	variations" to the standard terms which might otherwise have been habitually used by a party.	Bulk energy user companies.	are likely to create delays, lack of liquidity, operational and basis risks where documentation cannot be standardised for all customers.