20 September 2021

UCT Protections Team
The Treasury
Parkes ACT

By email: UCTprotections@treasury.gov.au

Dear Treasury UCT Protections Team

2021 Unfair Contract Terms Reforms

The Australian Financial Markets Association (AFMA) has reviewed the *Treasury Laws Amendment (Measures for A Later Sitting) Bill 2021: Unfair Contract Terms Reforms* (UCT Bill) and wishes to raise concern with how it may be applied in ways which are not intended by the Government.

In summary, from a financial markets contract perspective, the amendments being made by the UCT could allow it to be applied to standard form contract terms' that big businesses enter into with each other. This is a surprising development. From the Explanatory Memorandum and Regulation Impact Statement we see no indication that the Government intends this outcome.

As the Government explained in its 2015 Explanatory Memorandum, the extension of the unfair contract term protection to cover small business contracts was to address vulnerability by allowing unfair contract terms to be declared void, providing a remedy for small businesses. This will reduce the incentive to include and enforce unfair terms in small business contracts, providing for a more efficient allocation of risk in these contracts and supporting small business' confidence in agreeing to contracts. The emphasis was on 'small' business.

In 2014-15 consultations on the draft legislation AFMA warned that while the extension should achieve its objective of protecting genuine small businesses from unfair contract terms there needed to be a mechanism to ensure this part of the law would not intrude in the future into the wholesale 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

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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 contracts' provisions.

Many big businesses in the institutional financial market space have less than 100 employees and even less than 20 employees. Without some coupling of staff headcount to a business turnover threshold the revised definition will bring in a large segment of businesses with Australian financial services licenses dealing in the institutional markets within scope. From AFMA's perspective, we do not see a hedge fund manager managing billion investment portfolios as a small business, for example.

To date the legislation has not intruded into the institutional financial market contracting space. However, two changes in the UCT Bill, namely:

1. increasing the small business definition thresholds (so that the regime captures an expanded class of small business standard form contracts); and
2. removing the contract value threshold (so that the regime captures an expanded class of small business standard form contracts),

take us into the domain of big business financial market contracting and have the potential to open opportunities for unscrupulous litigation by an institutional financial market participant, presenting themselves as a defined 'small business', seeking to void their transaction by alleging an unfair term, such as a term allowing for unilateral variation in a swap contract.

The derivatives and Repo markets generally rely on terms in standard form agreements such as ISDA Master Agreements and GMRA Master Agreements, respectively. There is debate about whether these type of master agreements could come under the exemption as "individually negotiated contracts". However, serious legal doubt has been cast on this characterisation. The terms and conditions provided in international standard forms such as ISDA, GMRAs have been developed over many years. Where they provide (what may appear to be) a favourable one-sided position to one party against another, the terms have been drafted this way for good practical reasons. Their operations are specialised and complicated, such that a local court in Australia covering general consumer disputes may not be able to properly evaluate the fairness of such provisions generally, creating additional legal risks/uncertainties. Given the globalised nature of transactions in these type of financial products it would be highly destabilising and unacceptable to offshore counterparties if such agreements were not accepted under Australian law. The threat of such a contract being rendered void by a court could also mean netting arrangements were no longer valid.

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 receive related financial services offshore, and potentially increase their costs of getting such services.

AFMA is putting its concerns for how the reformed unfair contract terms might be used and misused by those that while falling within the new definition of 'small business' are actually a big business, into the broader context of what the Government is trying to achieve, which we support. AFMA expects ASIC to apply the law in its proper context and understand that this law is not about standard form contracts commonly used in the financial markets. AFMA would also expect the courts to see through and reject an unmeritorious claim by a big market player masquerading as a small business.

Nevertheless, the UCT Bill does create an area of new legal uncertainty, which is not good for efficient financial markets.

Another area of concern is where a Financial Market or Clearing House (both as defined in the Corporations Act) requires certain minimum terms to be included in a client agreement in order for a firm to utilise their services. If these terms were capable of being deemed "unfair terms" then the likely result is that financial market participants would need to cease providing small businesses with access to those markets.

AFMA also has a query. A small business contract to which a prescribed law of the Commonwealth, a State or a Territory applies, will be exempted out of application under the "standard form contracts" provisions. We assume this exemption covers legislative instruments, e.g. ASIC's Market Integrity Rules (Futures Markets) (e.g. Rule 2.2.5 which prescribes terms to be included in client agreements). Could you please confirm this is the case.

In conclusion, AFMA would like to open up a dialogue with The Treasury to discuss the potential for prescribing through subsection 12BL(2) a class of financial market contracts out of the definition of 'standard form contracts' to address legal uncertainty concerns.

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
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