

Chapter 3

Best interests duty

3.1 Under Division 2 of Part 7.7A of the Corporations Act, financial advisers providing personal advice to retail clients must comply with the 'best interests duty' and related obligations, which were introduced as part of the FOFA reform package. As noted earlier this reform measure was to improve the quality of financial advice received by retail clients. When introducing the original FOFA reforms, the then Minister for Financial Services and Superannuation stated:

The best interests duty is a legislative requirement to ensure the processes and motivations of financial advisers are focused on what is best for their clients.¹

3.2 In this chapter, the committee examines the proposal to remove paragraph 961B(2)(g), known as the 'catch-all' provision, from the list of steps providers may take in order to satisfy the best interests obligation.

Section 961B—provider must act in the best interests of the client

3.3 CPA Australia and the Institute of Chartered Accountants Australia noted that the majority of financial planners provide quality financial advice that is in the best interests of their client. The introduction of the statutory 'best interests' obligation, has 'embedded this obligation in the financial advice framework'. According to CPA Australia and the Institute of Chartered Accountants, the statutory best interests obligation:

...ensures providers of financial advice make certain the interests of their clients remain paramount, above and beyond those of the adviser, licensee and any relevant associates.²

3.4 According to Mr Paul Drum, CPA Australia, the best interests duty is the 'cornerstone of the FOFA reforms', with 'the ability to drive a cultural change within the financial services industry'.³

Removal of paragraph 961B(2)(g) known as the 'catch-all' provision

3.5 Subsection 961B(1) of the Corporations Act imposes a general obligation on providers to act in the best interests of the client.⁴ This general obligation is

1 ASIC, Regulatory Guide 175, *Licensing: Financial product advisers—Conduct and disclosure*, October 2013, p. 57.

2 *Submission 14*, p. 3.

3 *Proof Committee Hansard*, 22 May 2014, p. 29.

4 Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.21.

supplemented by a provision setting out steps that, if the provider can prove he/she has taken, 'will be taken to satisfy the general obligation'.⁵ The 2011 Explanatory Memorandum noted:

These steps have been set out based on the specific conditions under which advisers currently operate. This approach is needed given the broad nature of a best interests obligation; it may allow a provider to demonstrate that it has complied with the obligation by proving it took certain steps.⁶

3.6 Subsection 961B(2) records the seven steps that a provider 'may prove they have taken to demonstrate that they were acting in the best interest of the client'.⁷ It guides financial advisers on the measures they should complete to ensure that they are acting in the best interest of their clients when providing advice. ASIC refers to these measures as a 'safe harbour' for complying with the best interests duty in subsection 961B(1). It advises that showing that 'all of the elements in subsection 961B(2) have been met is one way for an advice provider to satisfy the duty in subsection 961B(1)'.⁸

3.7 The 2011 Explanatory Memorandum states that the steps set out in subsection 961B(2) were not intended to be 'an exhaustive and mechanical checklist of what it is to act in the best interest of the client'.⁹ It noted:

A provider may be able to demonstrate that it has, in fact, acted in the best interests of the client under subsection (1), without having recourse to subsection (2). However, as a general principle of statutory interpretation, it is expected that the interpretation of the general obligation in subsection (1) will be informed by the steps set out in subsection (2).¹⁰

3.8 The steps are intended to provide an indication of what, as a minimum, is expected of providers in order to be considered to have acted in the best interests of their client.¹¹ There are seven steps, the last of which is paragraph (g), also known as the 'catch-all' provision. Section 961B currently reads:

5 Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.21.

6 Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.21.

7 Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.23.

8 ASIC, Regulatory Guide 175, *Licensing: Financial product advisers—Conduct and disclosure*, October 2013, p. 65.

9 Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.25.

10 Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.25.

11 Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.25.

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- (1) The provider must act in the best interests of the client in relation to the advice.
 - (2) The provider satisfies the duty in subsection (1), if the provider proves that the provider has done each of the following:
 - (a) identified the objectives, financial situation and needs of the client that were disclosed to the provider by the client through instructions;
 - (b) identified:
 - (i) the subject matter of the advice that has been sought by the client (whether explicitly or implicitly); and
 - (ii) the objectives, financial situation and needs of the client that would reasonably be considered as relevant to advice sought on that subject matter (the client's relevant circumstances);
 - (c) where it was reasonably apparent that information relating to the client's relevant circumstances was incomplete or inaccurate, made reasonable inquiries to obtain complete and accurate information;
 - (d) assessed whether the provider has the expertise required to provide the client advice on the subject matter sought and, if not, declined to provide the advice;
 - (e) if, in considering the subject matter of the advice sought, it would be reasonable to consider recommending a financial product:
 - (i) conducted a reasonable investigation into the financial products that might achieve those of the objectives and meet those of the needs of the client that would reasonably be considered as relevant to advice on that subject matter; and
 - (ii) assessed the information gathered in the investigation;
 - (f) based all judgements in advising the client on the client's relevant circumstances;
 - (g) taken any other step that, at the time the advice is provided, would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances.

Note: The matters that must be proved under subsection (2) relate to the subject matter of the advice sought by the client and the circumstances of the client relevant to that subject matter (the client's relevant circumstances). That subject matter and the client's relevant circumstances may be broad or narrow, and so the subsection anticipates that a client may seek scaled advice and that the inquiries made by the provider will be tailored to the advice sought.

3.9 The bill intends to remove the last step described in paragraph (g) which requires the provider to show 'they have taken any other step (in addition to the six preceding ones) that would reasonably be regarded as being in the best interest of the client'.¹² The proposed legislation also removes section 961E, as a related

12 Item 10 repeals paragraph 961B(2)(g).

consequential amendment. This section specifies what would reasonably be regarded as being in the best interests of the client and currently reads:

It would reasonably be regarded as in the best interests of the client to take a step, if a person with a reasonable level of expertise in the subject matter of the advice that has been sought by the client, exercising care and objectively assessing the client's relevant circumstances, would regard it as in the best interests of the client, given the client's relevant circumstances, to take that step.

Opposition to changes to best interests obligations

3.10 A number of submitters strongly opposed the removal of paragraph 961B(2)(g) and consequential provisions. For example, Dr Paul O'Shea, consultant for National Seniors Australia, cited the intention of the legislation, which was to raise the bar, to make the obligation better and more substantial than it was pre-FOFA. But, in his opinion, removing paragraph (g), the only one in 961B(2) which refers to best interests, would 'take us back almost exactly' to the pre-FOFA position.¹³ National Seniors argued that the proposed amendment would reduce the advisers' responsibility to act in the best interests of the clients and allow advisers to hide behind a tick box exercise of a limited list of actions.¹⁴

3.11 Dr Marina Nehme contended that the current steps outlined in section 961B(2) were essential and 'do not add an unreasonable burden on the industry'. She explained further:

Section 961B(2)(g) is important as it acknowledges that 'one size does not fit all': the advice needed by a client may vary from one situation to the next and as such the steps that may be taken by the adviser to ensure that the advice is for the best interest of the client may be different. Further, the language of the paragraph makes clear that the relevant steps that may be taken are to be determined when the advice is provided and not in hindsight.¹⁵

3.12 Dr Nehme also referred to the importance of section 961E, which, in her view, provided the necessary clarification for paragraph 961B(2)(g) and as such should not be repealed. She argued that section 961E ensures that the best interests consideration under paragraph 961B(2)(g) was 'assessed objectively and accordingly does not impose an unreasonable burden on the industry'.¹⁶

13 *Proof Committee Hansard*, 22 May 2014, p. 68.

14 *Submission 24*, p. 7.

15 *Submission 8*, p. 4.

16 *Submission 8*, p. 4.

3.13 Professor Paul Latimer expressed concern that 'some in the financial services industry have attacked the "catch-all" duty in s 961B(2)(g) before and now after its commencement on the grounds that it makes the best interests checklist in s 961B uncertain'. He rejected their argument that the catch all would create difficulties for advice providers 'to fulfil the best interests test, and that it would be impossible for them to design efficient processes for compliance and for providing advice (ie to tick the box)'. According to Professor Latimer, compliance with the checklist in section 961B(2) by box ticking:

...potentially takes away the responsibility of advice providers to exercise their own judgment, with the danger that s 961B(2) could be seen as no more than a safe harbour for formal compliance by box ticking. This highlights the importance of the catchall in s 961(2)(g) to keep the box open for professional and independent judgment.¹⁷

3.14 He noted further the reservations held by some in the financial services industry that the open-endedness of this catch-all provision would create legal uncertainty that would make 'the checklist/safe harbour in section 961B(2) unworkable for advice providers'. According to Professor Latimer, some in the industry argued that advice providers who have followed the checklist may not have confidence that they have discharged their statutory best interests obligations. In response to this contention, he stressed that the open-ended paragraph 961B(2)(g) was 'exactly what the "any other step" is supposed to do'—'it removes a static and inflexible advice model (box ticking) that may fail to take full account of all of the client's relevant circumstances'.¹⁸

3.15 The ACTU also supported the retention of paragraph 961B(2)(g). It questioned the veracity of the statement in the Explanatory Memorandum, which noted the 'significant legal uncertainty' around how the best interests duty could be satisfied. The Explanatory Memorandum suggested further that without paragraph 961B(2)(g) the remaining safe harbour provisions set 'a high standard for providers to show they have acted in the best interests of their client'. According to the ACTU, both arguments were 'deeply flawed'.¹⁹ The ACTU stated that the Explanatory Memorandum offers no evidence that 'significant legal uncertainty' exists. Indeed, it noted that the new 'catch-all' provision was introduced in 2013 and a number of professional associations have issued advice to their members about how to meet the new obligation. It argued that parts (a) to (f) of subsection 961B(2) comprise:

...a series of process-related steps that are qualitatively distinct from being required to make the more substantive judgement that assessing a client's best interests demands. The process-related steps that the government

17 *Submission 2*, p. 13.

18 *Submission 2*, p. 13.

19 *Submission 5*, p. 3.

intends to retain are little more than a codification of what many financial advisers were doing before 1 July 2013.²⁰

3.16 In its view, repealing paragraph 961B(2)(g) would remove 'a key safeguard for advice clients'.

3.17 Similarly, CHOICE argued that without paragraph 961B(2)(g), paragraphs 961B(2)(a)–(f) would function as a 'tick-a-box' checklist to assess if the best interests obligation had been met. In its view, the absence of paragraph 961B(2)(g) would leave a test that contains no mention of protecting the client's best interest.²¹ It likewise rejected the contention of those seeking to remove 961B(2)(g) that the provision was too open ended, creating uncertainty as to how advisers could satisfy the obligation.

3.18 CHOICE also cited section 961E, which the bill proposes to remove. This section, as noted previously, defines the best interests of the client as 'any step that a person with a reasonable level of expertise who exercises care and objectively assesses the client's relevant circumstances would require'. In CHOICE's view, this definition 'addresses the information asymmetry inherent in the client-adviser relationship by linking the best interests obligation to subject matter expertise'. Ms Erin Turner from CHOICE explained:

People see advisers because they are not experts in the area on which they are seeking advice. What this section in particular did was recognise that 'best interests' is defined as something that someone who is a professional in this area would recognise as being in the best interests of the client [and] is incredibly important.²²

3.19 COTA was among those who supported retaining the catch-all provision, which in its view, provided 'an important consumer protection as it covers situations which do not neatly fit into the six preceding steps'. It argued:

If this last step were to be removed the other six steps become a 'tick a box' checklist and weaken the requirement for advisors to reflect in an overall sense on the advice they are giving and whether it would as a whole be considered in the client's best interest. The inclusion of paragraph (g) provides an extra degree of security for consumers that the advisor is acting for them.²³

3.20 The Governance Institute of Australia recommended that:

...the proposed amendment to the 'catch-all' provision in s 961B(2) should not proceed in its current form, that is, the amendment to this provision should not repeal the adviser's duty to act in the best interests of the client

20 *Submission 5*, p. 4.

21 *Submission 7*, p. 7.

22 *Proof Committee Hansard*, 22 May 2014, p. 13.

23 *Submission 10*, p. 4.

but clarify that the onus of proof rests with the person alleging the breach of this section.²⁴

3.21 The Australian Institute of Superannuation Trustees (AIST) opposed the removal of the best interests paragraph (g). It maintained that such a move:

...reduces the adviser's best interests duty to a checklist, by not requiring advisers to take all other reasonable steps. Further to this, the proposed changes remove what would be 'reasonably' in the best interests of clients by removing the 'what would a reasonable adviser do' test at 961E.²⁵

3.22 AIST stated further:

...although we agree and support the intent of the proposed section 961B, we would have preferred that this duty was worded less prescriptively and that a principles-based approach was taken. Section 52(2)(c) of the *Superannuation Industry (Supervision) Act 1993*—the obligation for superannuation trustees to act in the best interests of super fund member—illustrates that such an approach is not only possible, but successful.²⁶

The removal of 961B(2)(g) has the effect of removing this principles-based approach, with only a checklist of steps remaining. As such, we cannot support its removal. Further, we point out that it is wrong, both in and out of law, to continue to refer to this as a 'duty'.²⁷

3.23 Ms Robbie Campo, Industry Super Australia, regarded paragraph 961B(2)(g) as the key consumer protection in the legislation. She stated:

Its surgical removal will seriously compromise the consumer protection that exists in the best interests duty. Subsection (2) is a stand-alone clause. If you follow the steps in subsection (2), you are deemed to have met the best interests obligations set out in subsection (1). So the steps that are set out are very important.²⁸

3.24 According to Ms Campo, subsection (g) was the only one of the seven steps that mentioned acting in the client's best interests. She emphasised that, if you remove that provision, 'none of the other steps make any reference to the client's best interests'.²⁹

3.25 It should be noted, however, that when urged to provide instances that could be covered by paragraph 961B(2)(g) but were not included in (a) to (f), witnesses were unable to give such examples. All agreed that subsection 961B(1), which states

24 *Submission 11*, p. 3.

25 *Submission 22*, p. 6.

26 *Submission 22*, p. 6.

27 *Submission 22*, p. 7.

28 *Proof Committee Hansard*, 22 May 2014, p. 55.

29 *Proof Committee Hansard*, 22 May 2014, p. 55.

clearly that the provider 'must act in the best interests of the client in relation to the advice' was central to the best interests duty.

Support for changes to best interests obligations

3.26 CPA Australia and the Institute of Chartered Accountants Australia noted that the catch-all provision, paragraph 961B(2)(g), and section 961E, created a level of uncertainty given the open-ended nature of the obligation.³⁰ They were of the view that the current general obligation under subsection 961B(1) combined with the steps that a provider should undertake to satisfy this duty in subsection 961B(2), achieved 'an appropriate balance between a principles-based approach and providing regulatory certainty'.³¹ They explained further:

While we believe that these existing provisions are appropriate, their removal should address any concerns the industry has highlighted. Further, an adviser would still be required to show they have complied with the remaining six steps in s961B(2). This includes identifying the subject matter of the advice being sought by the client (explicitly or implicitly) and the client's relevant circumstances which would reasonably be considered as relevant to this advice.³²

3.27 Submitters in firm favour of removing paragraph 961B(2)(g) cited its open-ended nature which, they suggested, created uncertainty and had the propensity to generate ambiguity.³³ They rejected the argument that its removal would weaken the operation of the best interests duty. In their view, the general requirement to act in the best interests of the client in relation to advice and the 'safe harbour' other steps listed in section 961B provided adequate protection for consumers.³⁴ To their minds, the inclusion of a general catch-all provision upset the balance and essentially rendered the safe harbour not a safe harbour.³⁵ For example, according to the Insurance Council of Australia, 'the 'catch-all' provision in paragraph 961B(2)(g) created significant legal uncertainty and, because of its open ended nature, made the safe harbour unworkable for financial service providers. As a result, it strongly supported the removal of paragraph 961B(2)(g)'.³⁶ The Association of Independently Owned Financial Professionals also believed that removing the catch all provision from best interest would be 'a practical approach to a difficult conundrum'.³⁷

30 *Submission 14*, p. 3.

31 *Submission 14*, p. 3.

32 *Submission 14*, p. 3.

33 See for example, Mr Brad Fox, *Proof Committee Hansard*, 22 May 2014, p. 3.

34 *Submission 21*, p. 6.

35 Mr Richard Batten, *Proof Committee Hansard*, 22 May 2014, p. 39.

36 *Submission 9*, p. 2.

37 *Submission 26*, p. 4. Menico Tuck Parrish Financial Services also supported the removal of this catch-all provision.

3.28 Similarly, the Financial Planning Association (FPA) was concerned that the catch-all provisions of the best interests duty (paragraph 961B(2)(g) and section 961E) 'set an unclear and unrealistic expectation for even professional financial planners'.³⁸ It argued that:

- the words in the legislation 'taken any other step' (subsection 961B(2)(g)) and 'take a step' (section 961E) form an open-ended requirement that is practically impossible to satisfy;
- it was not clear what was intended by taking 'any other step' that is not already covered in the other provisions of section 961B;
- the consumer protection offered by the catch-all is less effective than the general law as it can only be realised through litigation by ASIC, and;
- the standard of conduct intended by the catch-all provision cannot be mandated by legislation or originate from the judiciary, but must emerge from a confluence of hard and soft regulation, legislation and self-regulation, and innovation.³⁹

3.29 With regard to the lack of clarity, the FPA argued that this uncertainty posed 'significant litigation risks for financial planners' that were 'only tenuously connected to a consumer protection benefit'.

3.30 Mr Batten, Minter Ellison Lawyers, informed the committee that the catch-all step in section 961B(2)(g) was not needed to protect consumers and that:

...the other six steps provide a full, appropriate and complete list of the steps that an adviser would, in all normal courses, need to take to ensure that, in the conduct of obtaining instructions, obtaining information about the clients, the process that they go through to formulate their advice reaches an appropriate conclusion for the client.⁴⁰

3.31 He argued that:

The best interest duty is about the process of giving advice, and the safe harbour should reflect that. Removing the catch-all step simply removes uncertainty for advisers. It will not affect the duty of advisers to place client interests ahead of their own.⁴¹

3.32 In his view, the proposed change had the potential to improve consumer outcomes by removing uncertainty and cost for the industry, improving the accessibility and availability of advice.⁴² He stated:

38 *Submission 15*, p. 4.

39 *Submission 15*, p. 4.

40 *Proof Committee Hansard*, 22 May 2014, p. 37.

41 *Proof Committee Hansard*, 22 May 2014, p. 36.

42 *Proof Committee Hansard*, 22 May 2014, p. 37.

...certainty and clarity are important for consumers and I think it is also important for business. The words 'best interest' will remain in the statute. They will remain in the first subsection of the section to clearly inform consumers, advisers and the courts as to how to approach the safe harbour—the context in which the safe harbour has been made. But I think that repealing the words in what is intended to be a safe harbour, what is intended to be a statement by parliament of how to do something, does not achieve its intended objective.⁴³

3.33 The Stockbrokers Association of Australia were confident that the removal of the catch-all from the best interests obligation would not detract from the effectiveness of the best interests duty. In its opinion, the best interests duty in section 961B would remain 'a detailed and robust obligation to ensure that personal advice is suitable for the particular client'. It noted that:

- the catch-all was only one of seven listed obligations in the best interests duty;
- investor protection was strengthened by the obligation to give appropriate advice (section 961G); and
- section 961J remained to ensure that the interests of the client were paramount.⁴⁴

3.34 Accordingly, it disagreed with the view that the removal of the catch-all would somehow remove the best interests duty, or that it would be substantially reduced.⁴⁵

3.35 Mr Brad Fox, Association of Financial Advisers (AFA), noted that several pre-eminent legal experts in financial services law have clearly stated that its removal would not reduce the standard applied to an adviser but would improve the legislation by removing ambiguity.⁴⁶ The SMSF Professionals' Association of Australia Limited was concerned that the provision as originally drafted had the potential to be too broad in its application when interpreted by regulators or the courts. It suggested that consequently the legislation:

...created uncertainty and a high compliance burden for financial advisors. Removing the provision will increase certainty and reduce costs for advisors with these benefits to flow on to consumers of financial advice.⁴⁷

Further, changing the legislative formulation of the best interest duty does not abrogate an advisors fiduciary duty at common law to act in the best interest of their client.⁴⁸

43 *Proof Committee Hansard*, 22 May 2014, p. 42.

44 *Submission 4*, p. 2.

45 *Submission 4*, p. 2.

46 *Proof Committee Hansard*, 22 May 2014, p. 1.

47 *Submission 21*, p. 6.

48 *Submission 21*, p. 6.

3.36 The SMSF Professionals' Association of Australia also argued that this amendment would 'reduce compliance costs for financial advisers and enhance the ability to deliver scaled advice to consumers who are seeking a limited subset of personal financial advice'.⁴⁹ Furthermore, it did not believe that the removal of section 961E would undermine the effectiveness of the best interests duty.⁵⁰

3.37 The Financial Services Council (FSC) noted that subsection 961B(1) establishes the best interests duty, and that there was 'no proposal to amend or repeal the duty requiring financial advisers to act in their client's best interests'.⁵¹ By and large, it welcomed the steps set out in subsection 2, which it described as essentially a process, except paragraph 961B(2)(g). In its view, this paragraph left 'the steps open-ended thereby creating ambiguity about what other reasonable conduct/steps the Parliament believed a provider must take in order to comply with the duty'.⁵² It stated:

An advice provider will have significant practical challenges in positively proving, as required by the provisions that the provider had 'taken any other steps that would reasonably be regarded as being in the best interests of the client'. As the obligation involves interpretative professional judgement (post the fact if the matter is taken to court) which reasonable minds may differ in their interpretation.⁵³

3.38 FSC obtained legal advice from Mr Ian Jackman SC and Mr Gregory Drew, which stated that the proposed amendments 'would not materially reduce the protective efficacy of the best interests obligation'.⁵⁴ It would, however, neutralise

...the practical difficulties that a provider may otherwise have in positively proving that he or she had 'taken any other step that would reasonably be regarded as being in the best interests of the client'.⁵⁵

3.39 Mr Kevin Tee, Treasury, explained that the intention behind (g) was 'to ensure that the section was flexible' while still trying to achieve the objectives of the best interests obligations. According to Mr Tee, however, the feedback had been very clear—rather than flexibility, it had caused uncertainty. He stated:

Stakeholders have been telling us that they are not sure what they need to do to show that they have actually satisfied the best interest duty. Instead of really being seven steps there are really like an infinite number of steps

49 *Submission 21*, p. 1.

50 *Submission 21*, p. 6.

51 *Submission 27*, p. 23.

52 *Submission 27*, p. 23.

53 *Submission 27*, p. 24.

54 *Submission 27*, p. 25.

55 *Submission 27*, p. 26.

because under almost any circumstance you could say, 'Well, you could've done this, this or this.'⁵⁶

Other best interests obligations

3.40 A number of submitters looked more broadly beyond subsection 961B(2) to contend that other provisions in the Act afforded adequate consumer protection. As noted above, the Stockbrokers Association of Australia cited sections 961G and 961J. These two key provisions reinforce the statutory obligation on advisers. In this regard, ASIC advised:

...the best interests duty in s961B, the appropriate advice requirement in s961G and the conflicts priority rule in s961J are separate obligations that operate alongside each other and apply every time personal advice is provided.⁵⁷

3.41 Section 961G requires that the provider must only provide the advice to the client if it would be reasonable to conclude that the advice is appropriate to the client.⁵⁸ Section 961J places an obligation on the provider to give priority to the client's interests when the provider knows or reasonably ought to know that there is a conflict between the client's interests and those of the provider or other parties such as an associate of the provider or a financial services licensee of whom the provider is a representative.⁵⁹

3.42 With regard to these other provisions, the FPA was firm in its view that removing the provisions would not water down the consumer protections of the FOFA regime and that:

- financial advice must still be in the client's best interest (section 961B);
- appropriate for the client (section 961G);
- the financial planner must still prioritise the client's interests (section 961J) ahead of their own; and⁶⁰

56 *Proof Committee Hansard*, 22 May 2014, p. 96.

57 ASIC, Regulatory Guide 175, *Licensing: Financial product advisers—Conduct and disclosure*, October 2013, paragraph RG 175.214.

58 While this requirement to give appropriate advice remains unamended, the second part of this section is amended which is discussed later in the report.

59 Section 961J lists all the other parties which in addition to those given above include an associate of a financial services licensee of whom the provider is a representative; or an authorised representative who has authorised the provider, under subsection 916B(3), to provide a specified financial service or financial services on behalf of a financial services licensee; or an associate of an authorised representative who has authorised the provider, under subsection 916B(3), to provide a specified financial service or financial services on behalf of a financial services licensee.

60 *Submission 15*, p. 4.

- professional judgement is required as one of the steps of the best interest duty (961B(2)(f)).

3.43 According to the FPA, paragraph 961B(2)(f) requires the financial planner to base all judgements they make in advising the client on the client's relevant circumstances, which includes judgement about the scope of the advice, the enquiries they make, the strategies and products they recommend.⁶¹

3.44 Mr Brad Fox, AFA, agreed that the amendments to the best interests obligations provisions would not undermine, water down or dilute and certainly would not remove the best interests duty. He supported the view that the best interest duty was 'a combined duty listed across a number of references within the law'.⁶² He stated further that the association had:

...asked publicly and privately for anybody to give us an example of what is not covered in (a) to (f) that would be in (g). Nobody has been able to give us an example. So we do not see how (g) helps the law. In fact, the opinions of the legal counsel that we have received is that having (g) does not increase the duty on the adviser at all. What it does have the propensity to do is increase the ambiguity for those interpreting the law. That plays out in two ways. One is obviously in the courts. The second is in external dispute resolution or FOS [Financial Ombudsman Service] settings where FOS might be trying to decide, 'What was intended by (g)?' and trying to develop circumstances that were never there and never designed to be there.⁶³

3.45 The association was also concerned about the potential for professional indemnity prices to rise as well, which would make the provision of advice more expensive and unworkable.⁶⁴ It should be noted that Mr Alan Kirkland, CHOICE, was not sure that to date there had been evidence of an increase in indemnity insurance premiums as a result of the current provisions.⁶⁵

3.46 Minter Ellison Lawyers also relied on other provisions in the Act to argue that the best interests obligations would not be weakened by the removal of the catch all step.⁶⁶ Mr Batten, Minter Ellison, explained that the duties imposed in Division 2 have three elements, the first being the client priority rule; the second being an appropriateness test; and the third being what is known as the best interests duty.⁶⁷

61 *Submission 15*, p. 4.

62 *Proof Committee Hansard*, 22 May 2014, p. 2.

63 *Proof Committee Hansard*, 22 May 2014, p. 3.

64 Mr Michael Nowak, *Proof Committee Hansard*, 22 May 2014, p. 3.

65 *Proof Committee Hansard*, 22 May 2014, p. 14.

66 *Submission 18*, p. 2.

67 *Proof Committee Hansard*, 22 May 2014, pp. 37–38.

3.47 In Minter Ellison's view, the most important duty was the requirement in section 961J for advisers to give priority to client interests when giving advice. Minter Ellison explained that this client priority rule was the essential element of a fiduciary duty, which 'governs all aspects of the role undertaken by an adviser in giving advice and it does not have any limitation on its operation where it applies'.⁶⁸ The law firm stated:

It is not therefore possible for an adviser to act in their own or their licensee's interests when giving advice. This includes deciding the scope and type of advice that the adviser believes that the client requires.⁶⁹

3.48 According to Minter Ellison, section 961E requires advisers to ensure that they only provide advice to the client if it would be reasonable to conclude that the advice was appropriate to the client. Accordingly, advisers must therefore determine that the advice given to clients is appropriate for those clients.⁷⁰

3.49 Finally, Minter Ellison argued that section 961B(1)—the obligation to act in the best interests of the client in relation to the advice—was 'only ever intended to address the process of providing advice'. The 2011 Explanatory Memorandum made this intention clear:

The principle guiding the application of the best interests obligation is that meeting the objectives, financial situation and needs of the client must be the paramount consideration when going through the process of providing advice. This principle is embedded in the framework for the best interests obligation.⁷¹

3.50 Minter Ellison reasoned that the steps in section 961B(2) were designed to set out the steps that would satisfy the general obligation in section 961B(1) to ensure that client interests were given priority 'when going through the process of providing advice'. It argued:

It can be seen from these references that, despite being the first mentioned duty in Division 2 of Part 7.7 A, s 961B is not and was never intended to be the paramount duty applying to advisers. The paramount duty is the client priority rule in s 961J. Section 961B simply supplements this duty by confirming that this duty also applies to the process of giving advice.⁷²

3.51 In giving oral evidence, Mr Batten underlined the argument that the key or fundamental or even paramount duty was encapsulated in section 961J, which, in his

68 *Submission 18*, p. 2.

69 *Submission 18*, p. 2.

70 *Submission 18*, p. 2.

71 Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.22.

72 *Submission 18*, p. 3.

words, 'expresses the fundamental essence of the nature of a fiduciary relationship'.⁷³ Mr Batten stated:

That is the duty that requires advisers to place client interest first. The origin of FOFA, and this part of FOFA in particular, is about, as we understand it, ensuring that financial advisers giving personal advice owe a fiduciary duty to clients. Obviously as legal practitioners fiduciary duty is familiar to us in an advice-giving context. In our view, we would see the obligation to put client interest first as the primary obligation in that regard.⁷⁴

3.52 The Financial Services Council also underlined the interconnectedness of other provisions in the Corporations Act and the law more broadly, stressing the importance of noting that the best interest duty was not a singular duty. It explained:

Whilst the steps in section 961B(2) are largely congruent with, they are additional to, the duty an adviser owes their client under general law fiduciary obligations (profit and conflict rules) and under contract law (and torts). As such advisers will operate under a number of, each slightly nuanced, disparate legal 'best interest' obligations which adds to the complexity and cost of the regime.⁷⁵

3.53 In their legal advice, Mr Ian Jackman SC and Mr Gregory Drew highlighted the paramount obligation imposed by section 961J:

For completeness, our advice notes that the best interests obligation must be read subject to other continuing provisions which expressly require that the provider must only provide advice that is appropriate to the client (s 961G) and that insofar as any conflicts of interest may arise, the provider must give priority to the client's interests when giving the advice (s 961J).⁷⁶

3.54 Aside from subsections 961B(1) and 961B(2), the FSC also referred to the requirements to:

- give appropriate advice (section 961G), including continuing to comply with 'know your client' and 'know your product';
- warn the client if the advice is incomplete or based on inaccurate information (section 961H); and
- prioritise the interests of the client.⁷⁷

73 *Proof Committee Hansard*, 22 May 2014, p. 39.

74 *Proof Committee Hansard*, 22 May 2014, p. 37.

75 *Submission 27*, p. 24.

76 *Submission 27*, p. 26.

77 *Submission 27*, p. 17.

3.55 As noted above, the FSC cited section 961H as another requirement intended to protect consumer interests. This section requires an advice provider to warn the client where personal advice is based on incomplete or inaccurate information.⁷⁸

3.56 In concluding its argument, the council observed that the government's proposed changes only amend two of the steps in section 961B(2) and 'do not repeal or amend any of the other significant consumer protection mechanisms built into the new legislative framework'.⁷⁹

3.57 In the view of the FSC, supported by a number of other submitters, the combination of all the measures makes up the best interests and related duties and 'provide significant bolstering to consumer protection mechanisms in the law'.⁸⁰ It should be noted that ASIC, in its regulatory guide, also noted that an AFS licensee has a specific obligation to take reasonable steps to ensure that its representatives comply with the best interests duty, citing not only section 961B but:

...appropriate advice requirement (s961G), obligation to warn the client if advice is based on incomplete or inaccurate information (s961H), and obligation to prioritise the interests of the client (s961J).⁸¹

3.58 The FSC had other concerns about the best interests duty. It noted that in addition to the ambiguity in the legislation discussed above, it had submitted previously that the term 'best interests' appears in other legislative contexts. It referred to subsection 52(2)(b) of the SIS Act and section 181 of the Corporations Act. In its view, there remained 'the potential for some degree of confusion or for incorrect assumptions to be made regarding its meaning in this context'. Alternatively, the courts may interpret the duty based on the outcomes of the advice process that is as a 'best advice' obligation, which is not only an impossible and unreasonable test for an adviser to defend but also contrary to the previous government's stated policy that:

...the focus of the duty should be on how a person has acted in providing advice rather than the outcome of that action.⁸²

3.59 According to the FSC, the Explanatory Memorandum also implies that compliance with the best interest obligations is measured through an outcomes test by inclusion of the wording 'better position'. It noted that the Explanatory Memorandum states:

78 Regulatory Guide 175: *Licensing: Financial product advisers—Conduct and disclosure*, Australian Securities and Investments Commission October 2013, p. 8.

79 *Submission 27*, p. 24.

80 *Submission 27*, p. 24.

81 Regulatory Guide 175: *Licensing: Financial product advisers—Conduct and disclosure*, Australian Securities and Investments Commission October 2013, p. 13.

82 Future of Financial Advice, Information Pack, 28 April 2011, p. 12, <http://ministers.treasury.gov.au/Ministers/brs/Content/pressreleases/2011/attachments/064/064.pdf> (accessed 24 April 2014).

...when determining the appropriateness of advice, an adviser must consider whether the advice provided could reasonably be expected to leave the client in a better position given their relevant circumstances.⁸³

3.60 The FSC was strongly of the view that the best interests duty must be a conduct duty and not an outcome duty (tested on the outcomes of the advice).⁸⁴ As noted above, the previous government had made this point clear:

The government recognises that the focus of the duty should be on how a person has acted in providing the advice rather than the outcome of that action.⁸⁵

3.61 Accordingly, the FSC recommended that the reference to 'better position' in the Explanatory Memorandum be removed or amended to reflect the stated policy.⁸⁶ The committee agrees with this suggestion.

Conclusion

3.62 The committee has taken into account the arguments in favour of retaining paragraph 961B(2)(g)—the catch-all provision and those advocating its removal. It understands the necessity to ensure that consumer protection provisions are not undermined by the proposed amendments. It equally understands that the open-ended nature of paragraph 961B(2)(g) generates uncertainty and ambiguity about what the provider is supposed to do. Moreover, the committee is persuaded by the evidence relying on the consumer protections provisions, including sections 961G, J and H and the best interests requirement in subsection 961B(1), that the removal of the catch-all provision would not dilute the best interest duty.

3.63 Specifically, an AFS licensee has a specific obligation to take reasonable steps to ensure that its representatives comply with the best interests duty (section 961B), appropriate advice requirement (section 961G), obligation to warn the client if advice is based on incomplete or inaccurate information (section 961H), and obligation to prioritise the interests of the client (section 961J).⁸⁷ Indeed, the committee is of the view that all of these provisions work together to ensure that, if this amendment goes ahead, there would be no dilution of the best interests duty, but a greater deal of certainty for both client and adviser.

83 *Submission 27*, p. 5.

84 *Submission 27*, p. 25.

85 *Submission 27*, p. 25 and Future of Financial Advice, Information Pack, 28 April 2011, p. 12, <http://ministers.treasury.gov.au/Ministers/brs/Content/pressreleases/2011/attachments/064/064.pdf> (accessed 24 April 2014).

86 *Submission 27*, p. 25.

87 Regulatory Guide 175: *Licensing: Financial product advisers—Conduct and disclosure*, Australian Securities and Investments Commission, October 2013, p. 13.

