Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Legal Framework for the Provision of Financial Advice and Sale of Financial Products to Australian Households

Background Paper 7

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CONTENTS

1. INTRODUCTION

This technical paper is prepared for the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industries (the 'Royal Commission'). Its purpose is to explain in general terms the legal framework within which financial advice is provided, and financial products are sold, to Australian households.

The legal framework comprises a complex and interlocking set of legal rules and remedies derived from the relevant legislation and the general law. The relevant legislation is the *Corporations Act 2001* (Cth) ('Corporations Act') and the *Australian Securities and Investments Commission Act 2001* (Cth) ('ASIC Act') and the (extensive) Regulations and other legislative instruments made pursuant to them. Chapter 7 of the Corporations Act governs (among other things) the provision of financial services and the offer and sale of financial products other than securities. Chapter 6D of the Corporations Act regulates the offer and sale of securities. Part 2, Division 2 of the ASIC Act deals with unconscionable conduct and consumer protection in relation to financial services and operates to the exclusion of the corresponding provisions in the Australian Consumer Law.[1] Neither Act is expressed to operate as a code. The legislation co-exists with, and informs and is informed by, applicable general law including contract, tort and, where relevant, fiduciary principles.

The paper is concerned with the provision of 'financial product advice' and the sale of 'financial products' as those terms are defined in the Corporations Act. It does not deal with the provision of credit (except for margin lending) which is separately regulated. Nor does it cover direct investment in physical assets such as real estate, collectables or precious metals.

It examines the legal framework that governs the provision of these products and services to households, as distinct from businesses. 'Households' for present purposes includes both individuals and the entities through which individuals typically organise their financial affairs, including private companies, trusts and self-managed superannuation funds ('SMSFs'). Consistent with the legislation, these individuals and entities will be referred to

[1] See *Competition and Consumer Act 2010* (Cth) ss 131 and 131A.

in this paper as ‘clients’. As we will see, the legal framework differs depending on whether clients are classified as ‘retail clients’ or ‘wholesale clients’.

The paper is organised as follows. This Chapter is introductory and includes a high-level overview of the participants in the wealth management sector and of the evolution of the current regulatory regime. Chapter 2 explains some of the key definitions that mark out the regulatory perimeter, including of financial product and financial product advice, and the distinction drawn in the legislation between retail and wholesale clients. Chapter 3 describes the legal framework governing the provision of financial product advice to households. Chapter 4 deals with the offer and sale of financial products. Chapter 5 looks specifically at the way in which the legal framework seeks to resolve conflicts of interest and duty that routinely arise in the context of those activities.

Annexure A contains a timeline of regulatory changes made since end of the FSR transition period in March 2004 and Annexure B summarises relevant law reforms announced by the Commonwealth Government that are not yet in full force.

1.1 Financial planning and wealth management

Over their lifetime clients may use a range of financial products connected with ‘wealth management’. Wealth management is an industry term used to describe ‘various forms of funds management (superannuation, managed funds and life insurance) and financial advisory services’.[2]

Financial products in the wealth management suite typically relate to ‘investing, superannuation, retirement planning, estate planning, risk management and insurance’.[3] They include term deposits and other deposits with authorised deposit-taking institutions (‘ADIs’), interests in registered managed investment schemes (‘MISs’) and wholesale collective investment arrangements, interests in regulated superannuation funds and SMSFs, investment bonds issued by insurance companies, pensions, annuities, listed and unlisted

[2] Theodore Golat, “Banks’ Wealth Management Activities in Australia” *RBA Bulletin - September Quarter 2016* 35.

[3] Australian Securities and Investments Commission, https://www.moneysmart.gov.au/investing/financial-advice. General insurance (such as car insurance, travel insurance, consumer credit insurance, or home and contents insurance) is not usually considered part of the wealth management sector and therefore is not the focus of this paper. Health insurance is not treated as a financial product for Corporations Act purposes and is therefore also out of scope.

securities (including shares, debentures, bonds and hybrids), on-exchange and over-the-counter ('OTC') traded derivatives, and life insurance policies providing death and total and permanent disablement, income protection and trauma cover. They also include margin loans which, unlike other forms of credit, are treated as financial products for the purposes of the Corporations Act.[4] Further, they include platforms and wraps (which are structures in which individual financial products selected by the client are held to facilitate custodial, transactional and reporting services)[5] and managed account arrangements.[6]

When a client acquires a financial product, a legal relationship arises between the client and the issuer of the financial product based in contract. The legislation identifies who is the issuer of a financial product; for some financial products, there may be more than one issuer.[7] Generally speaking the issuer is the 'person responsible for the obligations owed under the terms of the facility that is the product'.[8] Therefore, issuers include ADIs, RSE licensees,[9] life insurers, responsible entities, wholesale scheme operators, platform operators, and securities and derivatives issuers.

In situations where the client is acquiring the product from the issuer (rather than in the secondary market), the issuer will usually make pre-sale disclosure to the client and will be liable, alone or with others, for any defects in that disclosure. If the client is a retail client, disclosure is often mandatory and takes the form of a prospectus (if the financial products are securities) or a Product Disclosure Statement ('PDS') (in other cases).[10]

Clients acquire financial products through various channels and utilise a range of information sources in making their financial decisions. This may include taking advice

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[4] See *Corporations Act 2001* (Cth) s 761EA and 764A(1)(l). However, a credit facility is treated as a financial product for the purposes of the *Australian Securities and Investments Commission Act 2001* (Cth) Pt 2, Div 2: see Section 2.1 below.
[5] Australian Securities and Investments Commission, *Regulatory Guide 148 - Platforms that are managed investment schemes and nominee and custody services* (December 2016).
[6] Australian Securities and Investments Commission, *Regulatory Guide 179 – Managed discretionary account services* (September 2016).
[7] For example, each person who is a party to an OTC derivative is taken to be an issuer of the derivative in certain circumstances: see *Corporations Act 2001* (Cth) s 761E(5) and *Corporations Regulations 2001* (Cth) reg 7.1.04D. See also *Corporations Regulations 2001* (Cth) reg 7.1.04G (foreign exchange contracts).
[8] See *Corporations Act 2001* (Cth) s 761E (for financial products other than securities) and the corresponding Regulations.
[9] RSE licensees are licensed by the Australian Prudential Regulation Authority to operate regulated superannuation funds, under *Superannuation Industry (Supervision) Act 1993* (Cth) s 29D.
[10] Disclosure is discussed in Section 4.1 – 4.3 below. Special disclosure arrangements apply to platforms and managed discretionary account services, under ASIC policy: see *ASIC [CO 13/761] Financial requirements for custodial or depository service providers; ASIC [CO 13/762] Investor directed portfolio services provided through a registered managed investment scheme; ASIC Corporations (Managed Discretionary Account Services) Instrument 2016/968*.

from the product issuer or from another person (who may or may not be independent of the issuer). The legislation distinguishes between information and advice, and between financial product advice that is general and personal. Personal financial product advice may be provided as part of a holistic financial plan or on a more limited or episodic basis.[11]

In most cases, financial product advice will be provided to the client by the holder of an Australian financial services ('AFS') licence[12] or a representative of an AFS licensee. A representative may be an individual or a body corporate.[13] Individuals who are authorised to provide personal financial product advice to retail clients as licensees or as representatives of AFS licensees are included in the Register of Relevant Providers maintained by the Australian Securities and Investments Commission ('ASIC') under s 922Q of the Corporations Act.[14]

The structure of the wealth management sector is such that, when a client receives personal financial product advice from an individual adviser, that adviser is likely to fall into one of the following categories:

- An in-house adviser who is an officer or employee of a financial institution that also is or includes a product issuer (such as an industry superannuation fund or a bank). Typically, the adviser will use the financial institution's brand.
- An officer or employee of a 'corporate authorised representative' that is part of a dealer group. This is a common structure for financial planning businesses. The business will be operated by an independently owned proprietary company

[11] This is sometimes referred to as 'scaled advice'. See Australian Securities and Investments Commission, *Regulatory Guide 244: Giving information, general advice and scaled advice* (December 2012).

[12] As at 30 June 2017 there were 4,185 AFS licensees authorised to provide personal financial product advice, and 1,653 AFS licensees authorised to provide general financial product advice: Australian Securities and Investments Commission, *Annual Report 2016-17* 19.

[13] As to who is the provider of personal financial product advice to a retail client for the purposes of *Corporations Act 2001* (Cth) Pt 7.7A, Div 2, see s 961 discussed in Section 2.5 below. The provision of advice by 'robo-advisers' is discussed separately in Annexure C.

[14] There were 25,397 individuals on the Register as at 30 June 2017: Australian Securities and Investments Commission, *Annual Report 2016-17* 19. Although membership of a professional body is not compulsory for advisers, many of the individuals on the Register are members of one or more of the following bodies recognised for this purpose by ASIC: Association of Financial Advisers; Association of Independently Owned Financial Professionals; Association of Superannuation Funds Australia; Australian and New Zealand Institute of Insurance and Finance; Australian Institute of Superannuation Trustees; Chartered Accountants Australia and New Zealand; Chartered Financial Analyst Institute; CPA Australia; Financial Planning Association of Australia; Independent Financial Advisers Association of Australia; Institute of Managed Account Providers; Institute of Public Accountants; National Insurance Brokers Association; SMSF Association; and Stockbrokers Association of Australia. This gives a flavour of the diverse businesses and practices in which providers of personal financial product advice to retail clients are located.

authorised to provide designated financial services on behalf of the AFS licensee, and the adviser will be an officer or employee of the proprietary company. The 'dealer group' comprises all the businesses so authorised by the AFS licensee. The AFS licensee may be owned by a financial institution that also includes a product issuer or issuers, but this might not be apparent from the name of the dealer group[15]

- A stand-alone AFS licensee or a director or employee of a stand-alone AFS licensee.

The legal relationships between the client, the adviser, the corporate authorised representative and the AFS licensee in these different structures are explored in Section 3.12.

1.2 Evolution of the current framework

The current regulatory framework for financial advice and financial products sales was designed in the late 1990s.[16] During the 1990s, economic, political and social factors – including financial sector deregulation, changes to occupational superannuation arrangements, and expanding equity-market participation rates resulting from privatisations and demutualisations – had brought increasing numbers of middle-class households into the market for financial products and services. The funds management[17] and financial advice industries[18] began to grow. At the same time, innovation in the design of financial products resulted in the creation of new and sometimes complex financial arrangements and facilities,

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[15] In 2017 the major financial institutions used a number of brands in their advice businesses. These included: AMP: AMP Financial Planning, Hillross Financial Services, Charter Financial Planning, Advice First, SMSF Advice, and ipac; ANZ: ANZ Financial Planning, Elders Financial Planning, Financial Services Partners, Millennium3 Financial Services, and Ri Advice Group; CBA: BW Financial Advice, Commonwealth Financial Planning, Commonwealth Private, Commonwealth Securities, Count Financial, and Financial Wisdom; NAB: Apogee Financial Planning, Garvan Financial Planning, Godfrey Pembroke, JBWere, Meritum Financial Group, MLC Financial Planning, NAB Financial Planning, and NAB Financial Planning Self Employed; Westpac: Magnitude Group, Securitor Financial Group, and Westpac Banking Corporation.

[16] For a comprehensive discussion of the evolution of the regulatory framework for intermediaries, see R Baxt, A Black and P Hanrahan, *Securities and Financial Services Law* (LexisNexis, Sydney, 9th ed 2017) [1.39] – [1.54].

[17] B Mees, M Wehner and P Hanrahan, *Fifty Years of Managed Funds in Australia* (CCLSR Preliminary Research Report, 2005). Available at http://law.unimelb.edu.au/__data/assets/pdf_file/0008/1709909/91-50_Years_of_Managed_Funds1.pdf.

[18] For example, the Financial Planning Association was formed from precursor bodies in 1993 and commissioned the Birkett Report in 1996 to begin to formulate the knowledge and skills competencies required for financial planning. See M Cull, "The Rise of the Financial Planning Industry" (2009) 3 *Australasian Accounting Business & Finance Journal* 26; M Cull and T Sloan, "Characteristics of Trust in Personal Financial Planning" (2016) 2 *Financial Planning Research Journal* 10; W P Birkett, *Competency standards for financial planning in Australia and New Zealand* (Financial Planning Association, 1996).

blurring the boundaries between traditional classes of products and creating opportunities for regulatory arbitrage.

Following a comprehensive review of the (fragmented) regulatory arrangements then in place,[19] in 1997 the Financial System Inquiry chaired by Mr Stan Wallis ('Wallis FSI') recommended a comprehensive redesign.[20] At its heart was a recommendation that:

> A single market conduct and disclosure regulator for the financial sector should be established by the Commonwealth. This new body should seek to establish a consistent and comprehensive disclosure regime for the whole financial system, albeit one with flexibility to apply different rules, in response to different situations, beyond a common core. This regulator should also have responsibility for the regulation of advice and sales of retail financial products, including the licensing of financial advisers under a single regime. It should oversee industry-based schemes for complaints handling and dispute resolution and establish a common means of access for consumers.[21]

Contemporaneously, the Companies and Securities Advisory Committee published an influential report on the regulation of on-exchange and OTC derivatives markets[22] which pointed to the regulatory gaps and inconsistencies caused by the blurring of product lines,[23] and growing penetration of complex financial products into retail markets.

Following from the Wallis FSI, the first foundation stone of the current regulatory framework was put in place in 1998. In that year, ASIC was formed to combine the responsibilities of the predecessor Australian Securities Commission with the functions related to disclosure, sales and advice previously performed (in relation to financial products that were not securities or derivatives) by the Insurance and Superannuation Commission. Part 2, Division 2 of the ASIC Act was enacted, and responsibility for the consumer protection in the financial sector transferred from the Australian Competition and Consumer Commission ('ACCC') to ASIC.

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[19] Commonwealth of Australia, Financial System Inquiry, *Discussion Paper* (November 1996). Available at http://fsi.gov.au/publications/.
[20] Commonwealth of Australia, Financial System Inquiry, *Final Report* (March 1997). Available at http://fsi.gov.au/publications/.
[21] Ibid, 18.
[22] Commonwealth of Australia, Companies and Securities Advisory Committee, *Regulation of On-Exchange and OTC Derivatives Markets* (July 1997). Available at http://www.camac.gov.au/camac/camac.nsf/0/3dd84175efbad69cca256b6c007fd4e8.html.
[23] See e.g. *Sydney Futures Exchange Ltd v Australian Stock Exchange Ltd* (1995) 56 FCR 236; 16 ACSR 148.

This important structural reform was accompanied by the release, in December 1997, of the Treasury's Corporate Law Economic Reform Program Paper No. 6 ('CLERP 6') dealing with proposed reforms to the substantive regulation of financial markets and investment products.[24] CLERP 6 made several significant recommendations, which included:

- Proposal 1, for 'uniform regulation of financial instruments',
- Proposal 5, for a single licensing regime for financial market dealers and advisers,
- Proposal 6, setting statutory conduct requirements for intermediaries dealing with retail clients, including requirements relating to risk disclosure, confirmation documentation and periodic statements, accounts and record keeping, benefits disclosure, pressure sales, suitability of personal product recommendations, and complaints and dispute resolution,
- Proposal 7, for a consistent and comparable disclosure regime for all financial instruments other than securities.

In 1999 this was followed by a detailed consultation paper,[25] and then exposure draft legislation in February 2000 and a draft Bill in 2001.[26] From this, the other foundation stone of the current regulatory framework was laid with the enactment of the *Financial Services Reform Act 2001* (Cth) ('FSR'). The legislation commenced on 11 March 2002 subject to transition arrangements ending in March 2004. Among other things FSR established the current AFS licensing regime, imposed prescriptive conduct and disclosure obligations on financial advice providers dealing with retail clients, and put in place the PDS requirements for financial product sales.

Design features of the CLERP 6 framework

Although both Chapter 7 of the Corporations Act and Part 2, Division 2 of the ASIC Act have subsequently been amended extensively,[27] it is important to note that by the beginning of the century the regulatory design die was effectively cast. With the benefit of hindsight,

[24] Commonwealth of Australia, The Treasury, *Corporate Law Economic Reform Program Proposals for Reform: Paper No. 6 – Financial Markets and Investment Products: Promoting Competition, Financial Innovation and Investment* (1997). Available at http://archive.treasury.gov.au/documents/286/PDF/full.pdf.

[25] Commonwealth of Australia, The Treasury, *Financial Products, Service Providers and Markets: Implementing CLERP 6* (March 1999).

[26] The Explanatory Memoranda provide detailed and rich background to the Bill. Available at https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r1256.

[27] See Annexures A and B.

some key assumptions and decisions made in the late 1990s have had a significant impact on where we are today. They are worth drawing out because they help explain why the current legal framework functions the way it does.

The first was the decision to fold sales and advice relating to insurance and superannuation into the securities regulatory framework with its emphasis on independent intermediation and investor protection through mandatory disclosure and market integrity. Over-simplifying, what is now 'wealth management' was in the 1990s bifurcated between the 'insurance hemisphere', and the 'securities hemisphere', with non-superannuation funds management (managed funds, mortgage funds and property trusts) occupying a middle ground. Retail banks were only beginning their (later aggressive) expansion into wealth management, including through the acquisition of product issuers and distribution networks.[28]

In the old insurance hemisphere, the products were not usually traded in secondary markets. Decisions made by clients were more like consumption than investment decisions; they were seeking an outcome for themselves or their dependents, such as a lump sum benefit or income stream, on the happening of a nominated event (retirement, disablement or death).[29] The distribution channel was primarily through intermediaries who were or had previously been sales agents of product issuers - often life insurance agents. The securities world was different. The main distribution channels for primary offers and secondary sales of securities and futures were through brokers who executed trades and often also advised clients on investment opportunities or portfolio composition. The products were usually traded in tolerably transparent secondary markets (either on-exchange or OTC) and the decisions were more in the nature of investment or trading decisions, rather than consumption decisions.

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[28] Banks had offered advisory and execution services to high net worth clients through 'private banking', but this marks the beginning of the penetration of financial services into the mass market.

[29] Remember that, at this time, employers rather than employees made choices about where compulsory superannuation contributions would be invested. This may have involved an in-house superannuation scheme operated by the employer, although industrial awards dictated choice of fund in many industries. Member choice of fund was not introduced in Australia until 2005. RSE licensing was introduced in 2004; by the end of the implementation period there were 307 RSE licensees operating 6,900 RSE registered superannuation funds, down from 1,200 trustees operating 9,000 funds at the beginning of the transition period. This rationalisation of the public offer superannuation sector was significant. See Australian Prudential Regulation Authority, "New superannuation licensing era commences" (July 2006). Available at http://www.apra.gov.au/MediaReleases/Pages/06_34.aspx.

While this (necessarily) over-simplifies the wealth management landscape at the time, it does draw attention to how radical the two foundation stone reforms – the transfer of consumer protection for the financial sector from the ACCC to ASIC and the creation of the unified regulatory framework for all financial product advice and sales – were.

In this respect the package of reforms that flowed from the Wallis FSI and CLERP 6 was ground-breaking. Rather than reacting to a crisis, this was an attempt by government to accommodate and even anticipate developments in a rapidly growing and changing sector before legacy regulatory arrangements collapsed under the weight of innovation.[30] It is difficult to cavil with the design principle that functionally equivalent or substitutable financial products and services ought to be consistently regulated, and that regulation should be targeted at what the product or service does, rather than the institutional character of the entity that provides it. The original intention underlying the reforms was that there would be a coherent regulatory approach across the sector – a common regulatory architecture – rather than standardised regulation, but in practice this has proved elusive. The difficulty lies in the fact that the differences between different types of financial products and the purposes for which they are acquired by households are as significant as their overlap.

It is telling that the title of the CLERP 6 proposals paper is 'Financial Markets and Investment Products'. In the pursuit of consistency, the regulatory regime has obscured important legal and normative distinctions, for example between different markets and different sources of advice and between clients' consumption and investment choices.

The second important decision made in CLERP 6 was to regulate intermediaries (including advisers) at the firm level,[31] rather than the individual level as would be more typical in a profession. The reasons given include the need to ensure that government resources available for regulating intermediaries are most effectively targeted, and to facilitate market forces and competitive pressures. CLERP 6 concluded that, 'It is appropriate that the regime be targeted at the legal entity with responsibility for the intermediation process and with the incentives to ensure satisfactory outcomes for investors'.[32] Under this model, legal responsibilities to the client and to the regulator sit with the firm rather than the individual adviser; these include obligations on the firm as licensee to ensure its representatives are adequately trained and are competent to provide the

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[30] See generally, CLERP 6, above n 24, Pt 3.
[31] See CLERP 6, above n 24, 9; Wallis FSI, above n 20, 272. ASIC has the power to ban individuals from providing financial services, under *Corporations Act 2001* (Cth) Pt 7.6, Div 8.
[32] CLERP 6, ibid.

financial services, and to take reasonable steps to ensure that its representatives comply with the financial services laws.[33]

The third important decision was that there was no need for those giving financial advice to be independent of the product issuers. This is one of the most challenging aspects of CLERP 6; on careful reading it is hard to avoid the conclusion that in discussing the reform proposals for 'financial intermediaries' the authors of the proposals paper simply assumed that the intermediaries were just that – third parties who stood between and were independent of both clients and issuers in markets.[34] This is suggested, for example, by the description of 'a single licensing regime for regulating persons who provide professional services on which users rely, such as dealing or advising on financial instruments' to be introduced.[35] The proposals for conduct of business requirements for financial intermediaries included that 'all financial market intermediaries must disclose details of any benefit, advantage or interest they may receive as a result of making a recommendation about the purchase of a financial product, including fees or other commissions'.[36] The intermediary would be required to provide information on 'the nature of the relationship between the investor and the intermediary including the capacity in which the intermediary will be acting',[37] reflecting the long-standing requirement that insurance agents disclose the fact that (unlike brokers) they were acting for the insurer rather than the insured in arranging insurance. But there are no special arrangements or protections proposed where the intermediary services (including advice) are being provided by the product issuer or a related entity. Nor did the proposal consider or engage with the existing general law obligations of intermediaries (for example, the fiduciary duties of brokers and agents). This is considered in Chapter 5. It is at the root of the unresolved tension between a business model for financial advice that ties advisers commercially to product issuers while purporting to require them to act for the client.

The fourth important decision was that household access to wholesale markets and complex products would not be restricted. There would be no categories of financial product that were restricted to sophisticated clients; instead if the issuer of the product met the mandatory pre-sale disclosure requirements (and registration requirements in the case of managed investment schemes) any product – including complex and leveraged products and

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[33] *Corporations Act 2001* (Cth) s 912A(1). Under *Corporations Act 2001* (Cth) Pt 7.7A, Div 2, passed in 2012, statutory duties are imposed on individual advisers, but liability for breach of those duties sits with the licensee if the provider is not an authorised representative.
[34] CLERP 6, Pts 8 and 9.
[35] Ibid, 89.
[36] Ibid, 102.
[37] Ibid, 100.

exotic forms of alternative investments – could be offered to the retail market.[38] Clients were 'assumed to be the best judges of their own interests'.[39]

This open architecture is an important feature of the existing legal framework;[40] it reflects an underlying policy view that clients who are fully informed will be able to make rational product choices and to price products correctly.[41]

Subsequent refinements

The ambitious approach proposed by CLERP 6 to the regulation of financial markets and investment products proved difficult to implement. Giving effect to the main unifying principle – regulatory neutrality and flexibility – required an approach to legislative drafting that involved broad, over-inclusive rules which could be excluded or modified in particular instances.[42] Almost immediately after it came into effect, the FSR regime was the subject of 'refinement' and reform, including through Regulations and legislative instruments made by ASIC[43] as part of the FSR Refinements Project in 2005[44] and by the *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007* (Cth).[45]

The result is legislation that is labyrinthine. The definitions that mark out the regulatory perimeter are lengthy and often complex,[46] and spread throughout the

[38] In 2014, the Murray FSI observed that, 'The Wallis Inquiry's approach to consumer regulation was based primarily on disclosure. It did not restrict either the design of financial products or the type of financial products that could be marketed to retail clients. The focus of consumer protection was on regulating disclosure rather than products themselves'. Commonwealth of Australia, Financial System Inquiry, *Final Report* (2014) Ch 4.

[39] CLERP 6, above n 24, 27.

[40] See Australian Securities and Investments Commission, *Report 384 – Regulating complex products* (January 2014).

[41] As CLERP 6 says, 'Disclosure regulation aims to enhance market integrity and transparency by facilitating the adequate dissemination of information to assist: (1) the price formation process – prices should reflect all available information; and (2) investors to make informed investment decisions. Disclosure requirements promote the more efficient allocation of resources by assisting investors to choose investment products which will achieve their investment strategies and goals. Disclosure regulation addresses information imbalances by imposing disclosure requirements on issuers or promoters of financial products. This is generally a more practicable and cost-effective approach than requiring numerous unconnected potential investors to undertake research and due diligence inquiries in relation to an investment product'. CLERP 6, above n 24, 105.

[42] In *International Litigation Partners Pte Ltd v Chameleon Mining NL* (2011) 82 ACSR 517; [2011] NSWCA 50 at [74], Giles JA observes that this approach 'may not be desirable way to legislate, quite apart from the difficulty of tracking through the provisions and seeking to apply sometimes imprecise and convoluted language'.

[43] Until 2015, these legislative instruments were referred to as Class Orders.

[44] See Commonwealth of Australia, The Treasury, *Refinements to Financial Services Regulation – Proposals Paper* (May 2005). Available at http://archive.treasury.gov.au/contentitem.asp?ContentID=973&NavID=.

[45] See Baxt, Black and Hanrahan, above n 16, [1.50].

[46] Complexity of itself is not fatal. As Justice Ashley Black has observed, 'the complexity of some of these provisions, including the definitions of financial services in the Corporations Act and the insider

legislation.[47] Within that perimeter, the rules themselves are highly specific and detailed; these are often made in response to relentless industry pressure on governments and regulators to supply black-letter prescriptive rules and guidelines that allow compliance risk to be managed internally by firms using a check-box approach. As a result, the legislation has been justifiably described as 'obscure and convoluted'.[48]

Stronger Super, shorter PDSs and FoFA

Three major substantive reforms to the framework, directed at enhanced client protection, were made in the early part of this decade.

The first involved changes to default superannuation products for those who do not wish to, or do not have the skills to, engage in more active retirement planning.[49] The second was the introduction of the 'shorter PDS' regimes for certain classes of financial products from 2012, to try to resolve the ongoing problems with the utility of disclosure.[50] The third was changes to the regulation of personal financial advice made by the *Corporations Amendment (Future of Financial Advice) Act 2012* (Cth) and *Corporations*

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trading provisions which have attracted unfavourable judicial comment, may reflect the complex policy objectives which the legislation is seeking to achieve. If one is to have a regime for regulating financial products and services, then it is necessary to draw boundaries as to what is in it and what is outside it, and that process is not necessarily a simple one'. The Hon Justice Ashley Black, "Unfinished Business in Corporations Law Reform" (BLS Corporations Workshop, June 2016).

[47] In *Ku v Song* (2007) 63 ACSR 661; [2007] FCA 1189 at [175], Graham J noted that applying the share transfer provisions required 'reference to numerous sections and regulations, which themselves make no sense without reference to numerous definitions, often shrouded in obfuscation, and, needless to say, strewn throughout the Corporations Act and the Corporations Regulations in various places such as ss 9 and 761A and regulations 1.0.02 and 7.11.01', leading his Honour to observe at [176] that 'why the law had to be expressed in such an obscure way beggars belief'.

[48] In *International Litigation Partners Pte Ltd v Chameleon Mining NL* (2011) 82 ACSR 517; [2011] FCAFC 50 Young JA says at [152]–[153] 'It might be remarked at this initial stage that Ch 7 of the Corporations Act is drafted in the most obscure and convoluted manner … I know it is our job to make plain what is obscure, and I know that commercial lawyers are thought by the legislature to be so able to find loopholes that every possible eventuality must be thought of and covered. However, the main aim is to protect the investing public and the investing public gain little comfort from obscure legislation'.

[49] This underpinned much of the work of the Super System Review Panel, chaired by Mr Jeremy Cooper, in 2009-2010 and the subsequent Stronger Super reforms, including the introduction of MySuper. See https://strongersuper.treasury.gov.au/content/Content.aspx?doc=publications/information_pack/mysuper.htm.

[50] *Corporations Amendment (No 5) Regulations 2010* (Cth) and *Corporations Legislation Amendment Regulations (No 2) 2011* (Cth).

Amendment (Further Future of Financial Advice Measures) Act 2012 (Cth).[51] These changes are known as the 'FoFA' reforms.

The FoFA reforms followed from the recommendations of the Parliamentary Joint Committee on Corporations and Financial Services ('PJC')[52] in its inquiry into financial products and services chaired by Mr Bernie Ripoll MP in 2008-9. The PJC heard evidence of significant structural problems with the financial advice sector. Its final report to government in November 2009, the PJC made 11 recommendations, of which four were directed explicitly at raising the quality of financial advice. These were:

> (1) that the Corporations Act be amended to explicitly include a fiduciary duty for financial advisers operating under an AFS licence, requiring them to place their clients' interests ahead of their own;
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> …
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> (3) that the Corporations Act be amended to require advisers to disclose more prominently in marketing material restrictions on the advice they are able to provide consumers and any potential conflicts of interest;
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> (4) that the government consult with and support industry in developing the most appropriate mechanism by which to cease payments from product manufacturers to financial advisers; and
>
> …
>
> (9) that ASIC immediately begin consultation with the financial services industry on the establishment of an independent, industry-based professional standards board to oversee nomenclature, and competency and conduct standards for financial advisers.

Recommendation (4) was subsequently firmed into a proposal to ban commissions and other forms of conflicted remuneration in connection with personal advice to retail clients about investments.

The recommendations were largely adopted and the resulting reform program for financial advice can be divided into three tranches. The first is the FoFA reforms, which were initially legislated in 2012 and implemented (following some legislative turbulence)[53]

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[51] See generally, P Latimer, "Protecting the Best Interests of the Client" (2014) 29 *Australian Journal of Corporate Law* 8.

[52] Commonwealth of Australia, Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Financial Products and Services in Australia* (November 2009) (Ripoll Report). The PJC is established under Part 14 of the *Australian Securities and Investments Commission Act 2001* (Cth).

[53] The FoFA reforms were enacted by the then Labor government. After its election in 2013, the Coalition government proposed various changes to 'streamline' the FoFA legislation that were seen as

progressively over the following four years. The second was the establishment of ASIC's Register of Relevant Providers for individuals providing personal advice to retail clients. The third is the suite of measures, enacted in February 2017, to 'professionalise' the financial advice industry.[54] This third tranche will not come into full effect until 2025.

The significance of these reforms is explained in Chapters 3 and 4 below.

The Murray FSI

In 2014 the Financial System Inquiry chaired by Mr David Murray AO ('Murray FSI') looked at the regulatory framework for (among other things) financial advice and financial product sales.[55]

In its chapter on consumer outcomes, the Murray FSI concluded that:

> In terms of fair treatment for consumers, the current framework is not sufficient. The GFC brought to light significant numbers of Australian consumers holding financial products that did not suit their needs and circumstances — in some cases resulting in severe financial loss. The most significant problems related to shortcomings in disclosure and financial advice, and over-reliance on financial literacy'.[56]

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eroding many of its basic protections: see e.g., D Kingsford Smith, 'Coalition's FoFA "streamlining" will destroy protections' *The Conversation*, 14 February 2014, http://theconversation.com/coalitions-fofa-streamlining-will-destroy-protections-22584. Attempts by the government to effect those changes were rebuffed in the Senate including by, for example, the parliamentary disallowance of amending regulations. There was a period of uncertainty lasting several years about what the final form of the statutory obligations would be, which was not ultimately resolved until the enactment of the *Corporations Amendment (Financial Advice Measures) Act 2016* (Cth). For a summary of the legislative process, see https://futureofadvice.treasury.gov.au/Content/Content.aspx?doc=home.htm.

[54] The *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017* (Cth) provides for compulsory education requirements for both new and existing financial advisers; supervision requirements for new advisers; a code of ethics for the industry; an exam that will represent a common benchmark across the industry; and an ongoing professional development component. It provides for the establishment of the Financial Adviser Standards and Ethics Authority Ltd ('FASEA') as a standard-setting body for the industry. See Annexure B.

[55] See Commonwealth of Australia, Financial System Inquiry *Interim Report* (June 2014) Ch 6, dealing with product disclosure at [3-54] – [3-62] and financial advice at [3-63] – [3-73].

[56] See Murray FSI, above n 38, Ch 4.

The Murray FSI recommended certain changes to the legal framework. These are:

> 1. ***Make issuers and distributors more accountable for design and distribution of products and introduce a product intervention power***. To promote positive consumer outcomes, product issuers and distributors should take greater responsibility for the design and targeted distribution of products. This should strengthen consumer confidence and trust in the system and reduce the number of cases where consumer behavioural biases and information imbalances are disregarded. ASIC should also be enabled to take a more proactive approach to reduce the risk of significant detriment to consumers.
>
> 2. ***Focus financial firms and advisers on the interests of consumers***. To build confidence and trust in the financial system, firms need to take steps to create a culture that focuses on consumer interests. This should include addressing conflicted remuneration in life insurance advice and stockbroking. Underscoring the importance of improved standards and accountability, the Inquiry recommends giving ASIC enhanced powers to ban individuals from financial firm management. The Inquiry recommends lifting the minimum competency standards for financial advisers, improving transparency of adviser firm ownership and relabelling general advice (see also Recommendation 40: Provision of financial advice and mortgage broking). In addition, the Inquiry recommends enabling better access to quality guidance for home building and contents insurance to reduce the risk of underinsurance.
>
> 3. ***Facilitate innovative forms of disclosure, including by encouraging industry to further use technology***. Although the disclosure regime has evolved to reduce complexity over the last decade, consumer behavioural biases and commercial disincentives limit its effectiveness. The Inquiry sees scope to promote efficient communication of information to consumers in a way that responds to technological advances and changing consumer preferences (see also Recommendation 39: Technology neutrality). Risk and fee disclosure remains variable and consumer understanding low. In addition, industry should develop consistent standards to improve disclosure of risk and fees.[57]

That said, the Murray FSI favoured ‘an approach that streamlines and complements the current framework and strengthens the accountability of product issuers and distributors’[58] over a more radical redesign of the CLERP 6 framework.

[57] Ibid.
[58] Ibid.

2. KEY DEFINITIONS

This Chapter provides a roadmap for navigating key definitions that determine the perimeters of financial advice and financial product sales regulation in Australia. The definitions matter because they turn on or off various parts of the legal framework. They include the statutory definitions of:

- financial products, as used (differently) in the Corporations Act and the ASIC Act
- financial services, including the concept of carrying on a financial services business
- financial product advice, including the distinction between giving information and advice about financial products, and the difference between personal advice and general advice
- retail client, in contradistinction to the notion of wholesale client
- representative, authorised representative, and provider.

This Chapter is not a summary or an explanation of the definitions, nor is it an attempt to paraphrase the law. As noted in Chapter 1, these definitions are both complicated and complex, and their application at the margins can raise difficult legal questions.[59] There are real dangers in oversimplification and generalisation. That said, for this roadmap to be useful it must necessarily take a high-level view. So rather than focusing on questions of statutory interpretation at the margins, it starts from the position that wealth management products and services provided to Australian households are usually within the regulatory framework and concentrates on explaining why this is the case and where it is not. Technical details and references are relegated to the footnotes wherever possible.

2.1 Financial product

The cornerstone definition is ‘financial product’. Financial product is defined (differently) in Part 7.1, Division 3 of the Corporations Act and s 12BAA of the ASIC Act. In both Acts, there is a functional definition that operates subject to a list of ‘clearly-ins’ and an overriding list of ‘always-outs’.

[59] Consider, for example, the fine legal and commercial distinctions involved in deciding where certain complex financial instruments sold to local councils before the Global Financial Crisis fit in the definitional framework, in *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* (2012) 301 ALR 1; [2012] FCA 1028 (Rares J) and *ABN Amro Bank NV v Bathurst Regional Council* (2014) 309 ALR 445; [2014] FCAFC 65 (Jacobson, Gilmour and Gordon JJ).

The functional definition is framed[60] as 'a facility through which, or through the acquisition of which, a person' makes a financial investment,[61] manages a financial risk,[62] or makes non-cash payments.[63] Things on the clearly-in list are always financial products, regardless of whether they are caught by the functional definition, unless they are on the always-out list.[64] Things on the always-out list are excluded in every case.[65] The clearly-in and always-out lists are different as between the Corporations Act and the ASIC Act; the most significant difference is that credit facilities are on the list of always-outs under the Corporations Act[66] but clearly-ins under the ASIC Act.[67]

Concentrating on the clearly-ins under the Corporations Act, they include the following wealth management products (among others):

- a security, including a share or debenture of a body corporate[68]
- an interest in a registered MIS[69]
- an interest in a wholesale collective investment vehicle[70]
- a derivative[71]
- a life risk insurance product[72]

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[60] In *Corporations Act 2001* (Cth) s 763A and *Australian Securities and Investments Commission Act 2001* (Cth) s 12BAA(1).
[61] Defined in *Corporations Act 2001* (Cth) s 763B and *Australian Securities and Investments Commission Act 2001* (Cth) s 12BAA(4).
[62] Defined in *Corporations Act 2001* (Cth) s 763C and *Australian Securities and Investments Commission Act 2001* (Cth) s 12BAA(5).
[63] Defined in *Corporations Act 2001* (Cth) s 763D and *Australian Securities and Investments Commission Act 2001* (Cth) s 12BAA(6).
[64] The clearly-in lists are in *Corporations Act 2001* (Cth) s 765A and *Corporations Regulations 2001* (Cth) reg 7.1.05 to 7.1.07J and *Australian Securities and Investments Commission Act 2001* (Cth) s 12BAA(7) and *Australian Securities and Investments Commission Regulations 2001* (Cth) reg 2BA.
[65] The always-out lists are in *Corporations Act 2001* (Cth) s 764A and *Corporations Regulations 2001* (Cth) reg 7.1.04N and *Australian Securities and Investments Commission Act 2001* (Cth) s 12BAA(8) and *Australian Securities and Investments Commission Regulations 2001* (Cth) reg 2BB and 2BC.
[66] *Corporations Act 2001* (Cth) s 765A(1)(h)(i).
[67] *Australian Securities and Investments Commission Act 2001* (Cth) s 12BAA(7)(k).
[68] Defined in *Corporations Act 2001* (Cth) s 761A.
[69] Managed investment scheme is defined in *Corporations Act 2001* (Cth) s 9 and includes non-corporate collective investment arrangements such as listed and unlisted managed funds, exchange traded funds, property trusts, infrastructure trusts, mortgage funds and alternative investments such as agribusiness and forestry schemes, hedge funds, and limited partnerships. It also includes certain platforms. Schemes with more than 20 members or that are promoted by a professional promoter ordinarily must be registered with ASIC under *Corporations Act 2001* (Cth) Ch 5C if interests in the MIS have been issued in circumstances requiring the provision of a PDS under *Corporations Act 2001* (Cth) Pt 7.9.
[70] This includes a managed investment scheme that has more than 20 members or is promoted by a professional promoter that is not required to be registered under *Corporations Act 2001* (Cth) Ch 5C, usually because the requirement to provide a PDS under *Corporations Act 2001* (Cth) Part 7.9 has not been triggered. The PDS is not triggered if, for example, all the members of the scheme are wholesale clients.
[71] Defined in *Corporations Act 2001* (Cth) s 761D.

- an investment life insurance product[73]
- a superannuation product[74]
- an RSA product[75]
- a deposit with an ADI, including a basic deposit product[76]
- a government bond[77]
- a margin lending facility[78]
- a platform, wrap or other investor directed portfolio service (‘IDPS’)[79]
- a managed discretionary account (‘MDA’) arrangement.[80]

Within this list, the distinction between ‘securities’ and other financial products is important in the context of financial product sales, because the prospectus requirements in Chapter 6D apply to regulated offers of securities while the PDS requirements apply to regulated offers of other types of financial products.[81] Distinguishing the different types of financial products is also important because of the way the AFS licensing regime works. AFS licensees and their representatives are authorised to provide specified financial services in relation to designated types of financial products. If their activities fall outside these authorised services and products, adverse consequences can follow.[82]

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[72] Defined in *Corporations Act 2001* (Cth) s 764A(1)(e).
[73] Defined in *Corporations Act 2001* (Cth) s 764A(1)(f).
[74] Defined in *Corporations Act 2001* (Cth) s 764A(1)(g). This definition cross-refers to the *Superannuation Industry (Supervision) Act 1993* (Cth) and captures a beneficial interest in a regulated superannuation fund, an approved deposit fund, or a pooled superannuation trust.
[75] That is, a retirement savings account product as defined in *Corporations Act 2001* (Cth) s 764A(1)(h).
[76] Defined in *Corporations Act 2001* (Cth) s 761A. Basic deposit products are carved out of some of the regulatory requirements that apply in respect of other ADI deposits (such as term deposits).
[77] Defined in *Corporations Act 2001* (Cth) s 764A(1)(j).
[78] Defined in *Corporations Act 2001* (Cth) s 761EA.
[79] See Australian Securities and Investments Commission, *Regulatory Guide 148 - Platforms that are managed investment schemes and nominee and custody services* (December 2016). The client acquires an interest in an MIS that is exempt from registration, or an interest in a registered ‘IDPS-like’ scheme.
[80] See Australian Securities and Investments Commission, *Regulatory Guide 179 – Managed discretionary account services* (September 2016). The client acquires an interest in an MIS that is exempt from registration.
[81] CLERP 6 envisaged that the prospectus regime would continue to apply offers of interests in registered MISs but FSR adopted a different approach. CLERP 6, above n 24, 110.
[82] An AFS licence issued *Corporations Act 2001* (Cth) Pt 7.6 will specify the financial services the licensee is authorised to provide. Acting without proper authorisation is an offence and may give the client a right of rescission under *Corporations Act 2001* (Cth) s 925A.

2.2 Financial service

The legislation also defines when a person provides a 'financial service'. This occurs[83] where a person provides financial product advice,[84] deals in a financial product,[85] makes a market for a financial product,[86] operates a registered MIS,[87] provides a custodial or depository service,[88] provides a crowd-funding service,[89] or provides traditional trustee company services.[90] While many specific activities are carved out of the definition of financial service by the Regulations[91] and by ASIC instruments, generally speaking, in the wealth management context:

- a financial product issuer is likely to be dealing in financial products by issuing those products. However, this is not the case if (generally speaking) the issuer is a body corporate or unincorporated body and the dealing relates only to securities of that entity,[92]
- an intermediary who arranges for clients to acquire or dispose of financial products is likely also to be dealing in financial products,[93] but the client dealing on its own behalf is not,[94] and
- a person who provides financial product advice to a client will be providing a financial service (see below).

[83] *Corporations Act 2001* (Cth) s 766A.
[84] Defined in *Corporations Act 2001* (Cth) s 766B. See below.
[85] Defined in *Corporations Act 2001* (Cth) s 766C. Certain conduct is carved out of the definition of dealing: see *Corporations Regulations 2001* (Cth) reg 7.1.34 – 7.1.35C.
[86] Defined in *Corporations Act 2001* (Cth) s 766D.
[87] See *Corporations Act 2001* (Cth) s 601FB.
[88] Defined in *Corporations Act 2001* (Cth) s 766E; *Corporations Regulations 2001* (Cth) reg 7.1.40. See also Australian Securities and Investments Commission, *Regulatory Guide 148 - Platforms that are managed investment schemes and nominee and custody services* (December 2016).
[89] Defined in *Corporations Act 2001* (Cth) s 766F.
[90] *Corporations Act 2001* (Cth) s 766A(1A).
[91] See *Corporations Regulations 2001* (Cth) reg 7.1.29 – 7.1.33H.
[92] See *Corporations Act 2001* (Cth) s 766C. The definition of dealing ordinarily includes issuing, varying or disposing of a financial product. However a transaction entered into by: a government or local government authority, a public authority or instrumentality or agency of the Crown; or a body corporate or an unincorporated body (other than an investment company) is taken not to be ***dealing*** in a financial product if the transaction relates only to securities of that entity (or if the entity is a government, debentures, stocks or bonds issued or proposed to be issued by that government). See also Australian Securities and Investments Commission, *Regulatory Guide 36 – Licensing: Financial product advice and dealing* (June 2016).
[93] See *Corporations Act 2001* (Cth) s 766C(2); ASIC, ibid. The regulation of intermediaries that provide arranging but not advice is discussed in Chapter 4.
[94] See *Corporations Act 2001* (Cth) s 766C(3); ASIC, ibid.

A person who carries on a business of providing financial services[95] will usually be required to hold an AFS licence, because of s 911A of the Corporations Act.[96] By operation of s 911B, a person cannot provide a financial service on behalf of another person who is required to be licensed, unless that other person is licensed, and the provider is duly authorised.

2.3 Financial product advice

A person provides a financial service if they provide financial product advice. Financial product advice is defined in s 766B of the Corporations Act; it is a recommendation or statement of opinion, or a report of either those things, that is intended to influence a person or persons in making a decision in relation to a particular financial product or class of financial product, or an interest in a particular financial product or class of financial product, or could reasonably be regarded as being intended to have such an influence. Information is not advice. Nor is anything included in the PDS for a financial product.

There are two types of financial product advice: personal advice and general advice. Personal advice is defined in s 766B(3) of the Corporations Act, as financial product advice that is given or directed to a person in circumstances where the provider of the advice has considered one or more of the person's objectives, financial situation and needs, or a reasonable person might expect the provider to have considered one or more of those matters. All other financial product advice is general advice.[97]

ASIC considers the distinction between information, general advice and personal advice (whether full or 'scaled'[98]) to be important. A person is not required to be licensed to provide information about financial products. If a person provides general or personal advice, it must be appropriately licensed[99] or authorised, and there are distinct categories of authorisation that are linked to the competencies and resources the licensee must have.

[95] 'Financial services business' is defined in *Corporations Act 2001* (Cth) s 761A.
[96] *Corporations Act 2001* (Cth) s 911A is modified by *Corporations Regulation 2001* (Cth) reg 7.6.02AG and 7.6.02AGA.
[97] See Australian Securities and Investments Commission, *Regulatory Guide 36 – Licensing: Financial product advice and dealing* (June 2016) and Australian Securities and Investments Commission, *Regulatory Guide 244: Giving information, general advice and scaled advice* (December 2012).
[98] Scaled advice is advice that the provider and the client have agreed will be limited to particular issues: see Australian Securities and Investments Commission, *Regulatory Guide 244: Giving information, general advice and scaled advice* (December 2012).
[99] A financial product issuer need not be licensed to give general advice about its own products, subject to conditions: *Corporations Regulations 2001* (Cth) reg 7.1.33H

General advice must carry with it a prescribed warning.[100] Providing personal advice to retail clients attracts the additional disclosure and conduct requirements and remuneration restrictions in Parts 7.7 and 7.7A of the Corporations Act.

In distinguishing personal from general advice, ASIC describes factual information as 'objectively ascertainable information, the truth or accuracy of which cannot reasonably be questioned'.[101] In contrast, 'financial product advice generally involves a qualitative judgement about, or an evaluation, assessment or comparison of, some or all of the features of a financial product'.[102] ASIC says, 'factual information may be likely to be advice if it is presented in a way that is intended to, or can reasonably suggest or imply an intention to, make a recommendation about what a client should do'.[103]

ASIC takes the view that advice 'may be regarded as personal advice if it is presented in a way that means a reasonable person might expect you to have considered one or more of the client's objectives, financial situation or needs'.[104] The risk that advice will be treated as personal (thereby attracting additional regulatory requirements) is managed by the provider 'clarify[ing] with the client at the outset that you are giving general advice, and you do not, in fact, take into account the client's objectives, financial situation or needs'.[105]

2.4 Retail client

Some parts of the regulatory framework only apply if the client is a 'retail client'. These include the disclosure requirements in Part 7.7 (dealing with the provision of financial services to retail clients); Chapter 6D[106] and Part 7.9 (dealing with the offer and sale of securities and other financial products to retail clients); and the best interests obligations and remuneration restrictions in Part 7.7A of the Corporations Act.

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[100] *Corporations Act 2001* (Cth) s 949A.
[101] Australian Securities and Investments Commission, *Regulatory Guide 36 – Licensing: Financial product advice and dealing* (June 2016) and Australian Securities and Investments Commission, *Regulatory Guide 244: Giving information, general advice and scaled advice* (December 2012) at [RG 36.21] and [RG 244.24].
[102] Ibid, at [RG 36.18] and [RG 244.26].
[103] Ibid, at [RG 36.31] and [RG 244.29].
[104] Ibid, at [RG 36.36] and [RG 244.43].
[105] Ibid.
[106] Chapter 6D does not use the concept of retail client, but the circumstances in which disclosure to investors in the form of a prospectus or other disclosure document include where offers are made to similar categories of clients. See *Corporations Act 2001* (Cth) s 708.

Retail client is defined in s 761G and 761GA of the Corporations Act and Part 7.1, Division 2 of the Corporations Regulations. A client may be a retail client for some purposes, and a wholesale client for others. By virtue of s 761G(4), persons who are not retail clients are treated as 'wholesale' clients.

Section 761G(5) of the Corporations Act specifies that individuals are always treated as retail clients in relation to certain categories of general insurance.[107] Section 761G(6) deals with superannuation products and RSA products; it provides that a person (including an individual, company or trustee) who is provided with a superannuation product or RSA product is usually retail.[108] For other financial products and services, s 761G(7) has the effect that a person to whom a recommendation, offer or issue is made in connection with interests in a managed investment scheme will be treated as retail unless:

- the price for the provision of the interest equals or exceeds $500,000,[109] or
- the interest is provided for use in connection with a large business,[110] or
- the interest is not provided for use in connection with a business, and the person meets the minimum assets or income tests described below, or
- the interest is not provided for use in connection with a business, and the person meets the 'sophisticated investor' test described below, or
- the person is a professional investor, or
- the person is a related body corporate of a wholesale client.[111]

The trustee[112] of an SMSF is not automatically treated as a retail client.[113] Being treated as a retail client is sometimes perceived by clients as disadvantageous, because it means they

[107] This includes motor vehicle, home and contents, sickness and accident, consumer credit, travel, and personal and domestic property insurance.
[108] This includes where a person is advised to contribute to an SMSF, but not when the trustee of an SMSF is advised on how the fund should be invested: see *Jamieson v Westpac Banking Corp* (2014) 283 FLR 286; (2014) 98 ACSR 63; [2014] QSC 32 at [250] – [260].
[109] Calculated in accordance with *Corporations Regulations 2001* (Cth) reg 7.1.19.
[110] If the financial product, or the financial service, is provided for use in connection with a business that is not a small business (that is, a business employing less than 100 people it is or includes manufacturing, or less than 20 people otherwise), the business is treated as a wholesale client: see *Corporations Act 2001* (Cth) s 761G(7)(b) and (12).
[111] *Corporations Regulation 2001* (Cth) reg 7.6.02AD inserts s 761G(4A), with effect that 'if a financial product, or a financial service, is or would be provided to, or acquired by, a body corporate as a wholesale client, related bodies corporate of the client are taken to be wholesale clients in respect of the provision or acquisition of that financial product or financial service'.
[112] Often the trustee is a company of which members of the fund are directors.

cannot access products and services that are only offered to wholesale investors (for example, wholesale collective investment schemes that may have lower fees).

Price or value exceeds $500,000

Section 761G(7)(a) provides that a person will be treated as a retail client unless 'the price for the provision of the financial product, or the value of the financial product to which the financial service relates, equals or exceeds the amount specified in regulations made for the purposes of this paragraph, currently $500,000.[114] The price or value of several financial products acquired in the same transaction can be aggregated for this purpose.[115]

In most cases, 'superannuation-sourced money' as defined cannot be counted in assessing price or value under s 761G(7)(a) if the financial service being provided to the person is either financial product advice or, if the person is a retail client, the issue or sale of a financial product to the person in circumstances requiring the giving of a PDS.[116] Superannuation-sourced money is money that the financial services provider knows or ought reasonably to know is being paid to a person as a superannuation lump sum by the trustee of a regulated superannuation fund, or has been paid as an eligible termination payment or superannuation lump sum within the previous six months.[117]

High net worth clients

High net worth clients are treated as wholesale clients by operation of s 761G(7)(c) and (ca) of the Corporations Act and reg 7.1.28, reg 7.6.02AB (which inserts s 761G(7)(ca)), reg 7.6.02AC (which inserts s761G(7A) and (7B)) and reg 7.6.02AF of the Corporations Regulations. A person meets the test if, before acquiring the interests, they give the issuer a copy of a certificate given within the preceding two years by a qualified accountant that states that the person has net assets of at least $2.5 million or has a gross income for each of the last two financial years of at least $250,000. Their net assets and gross income are taken to include the assets and income of trusts and companies controlled by them.

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[113] In particular, if the trustee has net assets of at least $2.5 million it will qualify as a wholesale investor under the general test. See Australian Securities and Investments Commission, 14-191MR "Statement on wholesale and retail investors and SMSFs" (8 August 2014).
[114] *Corporations Regulations 2001* (Cth) reg 7.1.18 (price of investment-based financial products) and reg 7.1.19 (value of investment-based financial products). The dollar amount has not increased since 2001.
[115] *Corporations Regulations 2001* (Cth) reg 7.1.17B.
[116] *Corporations Regulations 2001* (Cth) reg 7.1.26.
[117] *Corporations Regulations 2001* (Cth) reg 1.0.20.

Sophisticated investors

The category of sophisticated investors is created by s 761GA, which commenced on 1 July 2007. It provides for this purpose that, in circumstances where a financial product or service is not provided for uses in connection with a business, a person is a not a retail client in relation to a financial product or service provided by an AFS licensee if:

- the licensee is satisfied on reasonable grounds that the client has previous experience in using financial services and investing in financial products that allows the client to assess the merits of the product or service, the value of the product or service, the risks associated with holding the product, the client's own information needs, and the adequacy of the information given by the licensee and the product issuer, and
- the licensee gives the client before, or at the time when, the product or advice is provided a written statement of the licensee's reasons for being satisfied as to those matters, and
- the client signs a written acknowledgment before, or at the time when, the product or service is provided that the licensee has not given the client a PDS, the licensee has not given the client any other document that would be required to be given to the client under Chapter 7 if the product or service were provided to the client as a retail client, and the licensee does not have any other obligation to the client under Chapter 7 that the licensee would have if the product or service were provided to the client as a retail client.[118]

Professional investors

Professional investor is defined in s 9 of the Corporations Act as modified by reg 7.6.02AE. It includes an AFS licensee, a body regulated by the Australian Prudential Regulation Authority ('APRA'), a body registered under the *Financial Corporations Act 1974* (Cth), a listed entity, or a related body corporate of a listed entity, an exempt public authority, an investment company or similar foreign entities. Relevantly, this category also includes a trustee of a superannuation entity with net assets of at least $10 million, and a person who

[118] The licensee must have reasonable grounds for forming the view that the investor is sophisticated: see *Australian Securities and Investments Commission* v *Elm Financial Services Pty Ltd* (2005) 55 ACSR 544 at [10] to [11] (Barrett J); *Australian Securities and Investments Commission* v *Maxwell* (2006) 24 ACLC 1 (Brereton J).

has or controls gross assets of at least $10 million (including any assets held by an associate or under a trust that the person manages).[119]

2.5 Representatives, authorised representatives and providers

Most AFS licensees are companies. The largest AFS licensees both by number of representatives and by funds under advice are either financial institutions or dealer groups owned by financial institutions. AFS licensees provide services to clients through their representatives. A ‘representative’ of an AFS licensee is:

- an authorised representative of the licensee
- an employee or director of the licensee
- an employee or director of a related body corporate of the licensee
- any other person acting on behalf of the licensee.[120]

The conditions under which a representative may provide financial services on behalf of an AFS licensee are set out in s 911B of the Corporations Act. The effect of s 911B is that, usually, a director or employee of a licensee or a related body corporate can provide financial services on behalf of the licensee without having to be explicitly authorised to do so.

‘Authorised representatives’ are different, because they are usually entities that are not related to the licensee. The authorised representative concept is the basis of the dealer group structure, because it allows unrelated entities to provide financial services on behalf of AFS licensees.

Part 7.6, Division 5 of the Corporations Act deals with the appointment of authorised representatives. This is done by written notice specifying the services that the representative is authorised to provide.[121] The representative may be an individual or a body corporate. Individuals cannot sub-authorise others, however if the authorised representative is a body corporate, it may with the consent of the licensee authorise an individual or class of individuals (for example, all directors of the corporate authorised representative from time to time) to provide the services on the licensee’s behalf.[122] The

[119] See *Corporations Regulations 2001* (Cth) reg 7.6.02AE and *MIS Funding No 1 Pty Ltd* v *Buckley* (2013) 96 ACSR 691; [2013] VSC 607.
[120] *Corporations Act 2001* (Cth) s 910A(a).
[121] *Corporations Act 2001* (Cth) s 916A.
[122] *Corporations Act 2001* (Cth) s 916B.

licensee must notify ASIC of its appointment of authorised representatives.[123] When a notice is given under this section, both the body corporate and the individual are ‘authorised representatives’ of the licensee.[124] A person may be the authorised representative of more than one licensee, so long as they all consent.[125]

The following figure illustrates the relationship where a licensee elects to provide services through one or more corporate authorised representatives.

When financial services are provided to retail clients, some statutory obligations are imposed on the AFS licensee and others on the authorised representative.[126] Part 7.7A of the Corporations Act, which contains the FoFA best interests and remuneration rules, also imposes obligations directly on a ‘provider’.[127] The provider is the individual who is to provide personal advice to a retail client.

3. PROVISION OF FINANCIAL ADVICE

This Chapter explains the legal framework within which financial product advice is delivered to households in Australia. It deals with the provision of both general and personal financial product advice to both wholesale and retail clients. The discussion dealing with the provision of personal advice to retail clients describes the position both before and after the the FoFA reforms, which commenced during the period under examination by the Royal Commission.

Financial product advice is, of course, a subset of financial advice. It is concerned specifically with recommendations that clients acquire particular financial products or

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[123] *Corporations Act 2001* (Cth) s 916F and *Corporations Regulations 2001* (Cth) reg 7.6.04.
[124] More relaxed requirements apply where the representatives are only providing financial services on behalf of the licensee in respect of basic banking products: see *Corporations Act 2001* (Cth) s 911B(1)(c).
[125] *Corporations Act 2001* (Cth) s 916B.
[126] See for example *Corporations Act 2001* (Cth) s 941B and 946A imposing disclosure obligations directly on authorised representatives.
[127] *Corporations Act 2001* (Cth) s 961. In Australian Securities and Investments Commission, *Regulatory Guide 244: Giving information, general advice and scaled advice* (December 2012), ASIC says at [RG 244.51], ‘This is in contrast to the obligations in Pt 7.7, which apply to the ‘providing entity’ that is, the AFS licensee or authorised representative that provides financial product advice’.

financial products in a particular class. Table 1 summarises the various elements of the legal framework for financial product advice.

Giving financial advice to households	
General law duty of care	If the advice is provided pursuant to an agreement or retainer, the contracting party will owe contractual duties, including an implied duty of care. An adviser can also be liable in negligence.
Fiduciary duties	If (as is likely in the case of personal advice) the adviser is a fiduciary, the ‘no-conflicts’ and ‘no-profits’ rules apply
AFS licensing requirements and obligations in Corporations Act Pt 7.6	An AFS licensee must have the capacity to comply with its obligations in s 912A, and comply with those obligations and its licence conditions
Conduct of business rules in Corporations Act Pt 7.8, Div 7	An AFS licensee must comply with requirements relating to unconscionability, client orders, dealing in markets
ASIC Act Pt 2, Div 2	The Part prohibits unfair contract terms, unconscionable conduct, misleading or deceptive conduct and unfair sales practices, and contains implied warranties
Corporations Act Pt 7.10	The Part prohibits false or misleading statements, fraudulently inducing dealing, dishonest conduct, and misleading or deceptive conduct
Additional requirements for advising retail clients	
Additional licensing requirements in Corporations Act Pt 7.6	The licensee must have a complying dispute resolution system and compensation arrangements
Disclosure requirements in Corporations Act Pt 7.7	This Part contains mandatory disclosure (Financial Services Guide) and general advice warning requirements
Additional requirements for giving personal advice to retail clients	
Disclosure requirements in Corporations Act Pt 7.7	This Part contains mandatory disclosure (Statement of Advice) requirements
Pre- FoFA: Corporations Act Pt 7.7	The licensee must satisfy the suitability rule in giving advice
Post-FoFA: Corporations Act Pt 7.7A	This Part contains the best interests obligations, and restrictions on conflicted remuneration

This section begins by briefly explaining each of these elements. It then considers the respective responsibility (and liability) of the various parties – the AFS licensee, the authorised representatives, and the individual adviser[128] - within the framework. It concludes with a summary of the remedies available to clients, and the enforcement options available to ASIC, when advice fails.

Unsolicited advice, advertisements and media

As noted, clients typically obtain information and solicit opinions from a range of sources in connection with decisions about financial products. These may include mainstream or specialist media, seminars, subscription newsletters, social media including chatrooms and blogs, professional advisers such as accountants and lawyers,[129] and friends and family. They will also include marketing and sales material provided by product issuers or service providers.

Some of these communications are regulated under the financial services laws, usually on the basis that they entail the provision of general advice,[130] but the regulatory coverage is patchy and often counter-productive (for example, because it suggests to clients that something is 'advice' when it is in fact marketing).[131] Sometimes the provider must be licensed or be a representative of an AFS licensee; sometimes the material must be accompanied by a general advice warning which may be a full or abridged warning depending on the circumstances; and sometimes a Financial Services Guide (FSG) must be provided. Deciding whether a communication is general advice and if so whether it triggers these requirements requires a very close reading of Pts 7.1, 7.6 and 7.7 of the Corporations Act and the Corporations Regulations. These include many detailed provisions identifying specific activities and turning on or off the different parts of the regulatory framework, either by excluding the communication from the definition of financial service or the definition of financial product advice, or by exempting the person making the communication from a particular requirement.[132] Little if anything is gained and there is a

[128] The discussion focuses on the provision of advice to clients by individuals, rather than by advice algorithms. 'Robo-advice' will be addressed separately in a later paper.

[129] Legal and tax advice is carved out by *Corporations Act 2001* (Cth) s 766B(5). Various professional activities are classed as 'exempt services' by *Corporations Regulations 2001* (Cth) reg 7.1.29. However, if a professional adviser gives financial product advice outside these constraints, he or she must be appropriately licensed or authorised.

[130] To be within the definition of financial product advice, the communication must have the potential to influence a decision about a particular financial product or class of financial products.

[131] The Productivity Commission recently said, 'To ensure consumers are able to clearly distinguish between general promotional effort related to products and actual personal advice, use of the term 'advice' should be limited to effort that is undertaken on a client's behalf by a professional adviser. Currently, the terminology of advice requires consumers to intuitively understand that general advice is like marketing; and personal advice is actually tailored to their situation and carries with it some protection against misuse.' Commonwealth of Australia, Productivity Commission, *Competition in the Australian Financial System – Draft Report* (January 2018) 29.

[132] A product issuer may publish general advice about its own products in the media without being licensed to advise, as long as the advice complies with the requirements in *Corporations Regulations*

compelling case to be made for instead regulating all communications other than personal advice under the general rules in Part 7.10 of the Corporations Act and Part 2, Division 2 of the ASIC Act dealing with misleading or deceptive conduct.

Given the state of the law about these other communications, this section deals only with the legal framework governing the provision of advice that has been actively sought by the client from financial product issuers or financial intermediaries (that is, financial planners, financial advisers, private bankers, brokers, insurance intermediaries and, in relation to SMSFs, accountants).

3.1 General law duty of care

Depending on the circumstances in which a client seeks a recommendation or statement of opinion from a product issuer or financial intermediary about a financial product or class of financial product, a duty of care may arise in contract and tort. Where both arise, the duties are concurrent and co-extensive.[133]

If the advice is given in the course of a contractual relationship between the parties, the scope of the AFS licensee's duties to its client will depend upon the terms of the contract between the licensee and that client.[134] This will include the scope of the advice sought and provided. If there is a written contract between them, its terms may be supplemented by terms implied under general contractual principles.[135] If advice is given, then there is an implied contractual duty to exercise proper professional skill and care in the formulation of that advice.[136]

2001 (Cth) reg 7.6.01(1)(o). Nor need its licence cover advice if it is only providing general advice about its own products to other AFS licensees: see *Corporations Regulations 2001* (Cth) reg 7.6.01(1)(u).

[133] *Jamieson v Westpac Banking Corp* (2014) 283 FLR 286; (2014) 98 ACSR 63; [2014] QSC 32 at [87].

[134] *Midland Bank Trust Co Ltd v Hett Stubbs & Kemp* [1979] Ch 384 at 402–3; *Hawkins v Clayton* (1988) 164 CLR 539 at 544; [1988] HCA 15.

[135] *Secured Income Real Estate (Aust) Ltd v St Martins Investment Pty Ltd* (1979) 144 CLR 596 at 606; [1979] HCA 51; *Con-Stan Industries of Australia Pty Ltd v Norwich Winterthur Insurance (Aust) Ltd* (1986) 160 CLR 226 at 241; [1986] HCA 14.

[136] See D E Allan, "Bankers' Liability for Financial Advice" (1987) 16 *Melbourne University Law Review* 213, 216.

A contract for the supply of financial services by a person to a consumer[137] in the course of a business includes an implied warranty that the services will be rendered with due care and skill.[138]

An AFS licensee may be held liable for loss suffered by its client under negligence principles, even if there is no contract between them.[139]

In order to succeed in a claim in negligence, that client must establish that the licensee owed the client a duty of care; that the licensee breached that duty of care; and that the client suffered loss or damage as a result of that breach, which was not too remote.

A licensee that holds itself out as having special skill and expertise in offering advisory services to clients or potential clients may be held liable in negligence for losses resulting from a client's reliance on advice given by that licensee without reasonable care. In *Hedley Byrne & Co Ltd v Heller,*[140] Lord Reid observed that a person who offered advice in circumstances where that person knew that his or her advice would be relied upon, and did so without a qualification that he or she accepted no responsibility for the advice, must be held to have accepted some responsibility for his or her answers being given carefully, or to have accepted a relationship with the inquirer which requires him or her to exercise such care as the circumstances require. In *Mutual Life & Citizens Assurance Co Ltd v Evatt,*[141] Barwick CJ expressed the view that liability for negligent misrepresentation could arise

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[137] A client is a consumer if the price of the services did not exceed $40,000 or the services were of a kind ordinarily acquired for personal, domestic or household use: *Australian Securities and Investments Commission Act 2001* (Cth) s 12BC(1); *Leveraged Equities Ltd v Goodridge* (2011) 274 ALR 655; [2011] FCAFC 3.

[138] *Australian Securities and Investments Commission Act 2001* (Cth) s 12ED(1)(a). If the purpose of seeking services or the result that is desired from those financial services is made known to licensee, s 12ED(2) implies a warranty that those financial services will be reasonably fit for their purpose and of such a nature and quality that might reasonably be expected to achieve that result, unless the circumstances show that the consumer does not rely, or that it is unreasonable for it to rely, on the skill and judgment of the financial services provider. Such reliance may not be reasonable if the financial services provider qualifies or limits its advice. The implied warranties are discussed in Section 3.5 below.

[139] This occurred, for example, in *Jamieson v Westpac Banking Corp* (2014) 283 FLR 286; (2014) 98 ACSR 63; [2014] QSC 032 at [298], where 'the bank was not in a contractual relationship with the trustee. However, the facts previously outlined show that a trustee of the self-managed superannuation fund to be organised by Mr Jamieson was plainly in the bank's foresight and actual contemplation in making the recommendation that the amount to be borrowed by Mr and Mrs Jamieson be contributed to their self-managed superannuation fund and that it be invested in self-funding instalment warrants. In my view, there is no call to discuss the facts in more detail in order to come to the conclusion that the bank owed a duty of care to the trustee in making that recommendation'.

[140] *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465 at 503.

[141] *Mutual Life & Citizens Assurance Co Ltd v Evatt* (1968) 122 CLR 556; 42 ALJR 316 at 321; [1968] HCA 74.

from the making of a representation by a person who possessed particular expertise in circumstances that the information could reasonably be acted upon by another person, who might suffer financial loss as a result.[142]

Therefore, a duty to exercise reasonable care in making a statement or giving advice exists where the speaker realises, or ought to have realised, that the recipient of information or advice intended to act on that information or advice in connection with a matter of business or serious consequence, and it was reasonable in all the circumstances for the recipient to accept and rely on the speaker's statement, having regard to the nature of its subject matter, the occasion on which the statement is made, the identity and relevant positions of the parties, including their knowledge and capacity to exercise judgment.[143] Proof of the matters giving rise to a duty to exercise reasonable care in respect of the giving of advice is sufficient to establish an assumption of responsibility and relevant vulnerability on the part of the person who received the advice.[144] Those factors are also sufficient, where expert information and advice is provided, to establish that a reasonable person would have foreseen that its conduct involved a risk of injury to a class including the plaintiff.[145] To the extent that a financial services licensee's liability for advice arises under *Hedley Byrne* above, it is generally able to avoid that liability by use of a disclaimer which makes it clear that it does not accept responsibility for any advice that it offers.[146]

Whether a financial services licensee has breached a duty of care owed to its client is a question of fact, which must be answered in a particular case by reference to the standard of care which is reasonable in the circumstances. Although a licensee is not required to have an extraordinary level of skill or the highest professional attainments, it must exercise due care, skill and diligence, and must bring to its task the competence which is usual among persons practising as financial services licensees and, if the licensee has a

[142] Although the Privy Council took a narrower view in *Mutual Life & Citizens Assurance Co Ltd v Evatt* [1971] AC 793, the reasoning of Barwick CJ was adopted by the High Court in *Shaddock v Parramatta City Council* (1981) 150 CLR 225; [1981] HCA 59 and in *San Sebastian Pty Ltd v Minister Administering Environmental and Planning Assessment Act 1979* (1986) 162 CLR 340; [1986] HCA 68.
[143] *Tepko Ltd v Water Board* (2001) 206 CLR 1; [2001] HCA 19 at [47]; *ABN Amro Bank NV v Bathurst Regional Council* (2014) 309 ALR 445; [2014] FCAFC 65 at [574].
[144] *Woolcock Street Investments Pty Ltd v CDG Pty Ltd* (2004) 216 CLR 515; [2004] HCA 16 at [23]–[24]; *ABN Amro Bank NV v Bathurst Regional Council* (2014) 309 ALR 445; [2014] FCAFC 65 at [575].
[145] *ABN Amro Bank NV v Bathurst Regional Council* (2014) 309 ALR 445; [2014] FCAFC 65 at [588], [593].
[146] Baxt, Black and Hanrahan, above n 16, [14.3].

special skill or competence, then the applicable standard of care is that of the ordinary skilled person exercising and professing to have that special skill.[147]

The extent of advice which a licensee is required to offer its client, in exercising a reasonable degree of care and skill, will depend in part on the extent of the client's existing understanding of the relevant financial products or market.[148] Evidence of the practice of financial services licensees of the relevant class will not necessarily be determinative of the conduct necessary to discharge a financial services licensee's obligations under the duty of care owed to its client, whether in tort or in contract, although it may provide a sound guide to what is reasonable.[149] The test has been expressed as 'that no reasonable financial adviser called upon to advise her [at the relevant time] and to make investment recommendations to her at that time should have included within his or her recommendations for investment, investment in either of the [products recommended]'.[150]

3.2 Fiduciary duties

Financial product issuers and financial intermediaries that provide personal advice to a client may owe fiduciary duties to that client, depending on the nature and circumstances of their interaction.

In fiduciary relationships, equity imposes two interrelated proscriptions, the 'no conflicts rule' and the 'no profits rule'. These rules are directed, in the words of the Full Federal Court, at exacting 'disinterested and undivided loyalty from the fiduciary'; hence

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147 *Voli v Inglewood Shire Council* (1963) 110 CLR 74 at 84; [1963] HCA 15; *Midland Bank Trust Co Ltd v Hett Stubbs & Kemp* [1979] 1 Ch 384 at 403.

148 *Rest-Ezi Furniture Pty Ltd v Ace Shohin (Aust) Pty Ltd* (1987) 5 ACLC 10; *Lloyd v Citicorp Australia Ltd* (1986) 11 NSWLR 286 at 288. So, for example, in *Jamieson v Westpac Banking Corp* (2014) 283 FLR 286; (2014) 98 ACSR 63; [2014] QSC 32 at [284], 'The assessment of what was required by way of explanation to Mr and Mrs Jamieson in presentation of the updated statement of advice, in discharge of the bank's contractual duty and the corresponding duty of care in negligence, must be made against the context, known to Mr Tindall, that Mr Jamieson was an investor with experience in the Australian share market as chief executive officer of a listed public company who had a large personal share portfolio with an associated margin loan. In my view, it was no breach of contract or negligence not to explain the relatively leveraged exposure of an investment in self-funding instalment warrants, in comparison to a direct investment in shares in the Australian share market in the updated statement of advice.'

149 *Pacific Acceptance Corporation Ltd v Forsyth* (1970) 92 WN (NSW) 29 at 74; *Midland Bank Trust Co Ltd v Hett, Stubbs & Kemp*, above at 402; *Edward Wong Finance Co Ltd v Johnson, Stokes & Master (a firm)* [1984] AC 296 at 306.

150 *Jordan v HLB Mann Judd Wealth Management (NSW) Pty Ltd* (2013) 93 ACSR 344; [2013] FCA 315 at [126] (Foster J).

their 'focus on conflicts between duty and undisclosed personal interest, conflicts between duty and duty, and misuse of a fiduciary position for personal gain or benefit'.[151]

Financial services firms are not within the accepted status-based categories of fiduciary relationships recognised under Australian law, which include those between trustee and beneficiary, agent and principal, solicitor and client, director and company, and partners.[152] However the nature of the particular interaction between the adviser and the client may give rise to fiduciary obligations in respect of the giving of advice.[153] While there is 'no generally agreed and unexceptionable definition', a person may be treated in equity as a fiduciary 'when and insofar as that person has undertaken to perform such a function for, or has assumed such a responsibility to, another as would thereby reasonably entitle that other to expect that he or she will act in that other's interest to the exclusion of his or her own or a third party's interest'.[154] This will in many cases describe the relationship between a financial services firm and its client, at least with where the firm is advising the client.

In *Daly v Sydney Stock Exchange Ltd*,[155] the client approached a stockbroker for investment advice. That 'a stockbroker who is engaged to buy or sell shares on behalf of his client [is] an agent subject to a fiduciary's obligations in buying and selling' is well-established. But in *Daly*, the stockbroker 'did not buy or sell shares on behalf of Dr Daly. Dr Daly sought advice from Patrick Partners on the investment of his money and they advised him'. The question before the High Court was whether the relationship between the

151 *Grimaldi v Chameleon Mining NL (No 2)* (2012) 200 FCR 296; [2012] FCAFC 6 at [177] (Finn, Stone and Perram JJ) at [174].
152 *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 68 per Gibbs CJ, 96 per Mason J; 55 ALR 417; [1984] HCA 64.
153 For a discussion of the circumstances in which a financial adviser may owe fiduciary obligations to the client, and the nature of those obligations, see Pamela Hanrahan, "The relationship between equitable and statutory 'best interests' obligations in financial services law" (2013) 7 *Journal of Equity* 46. See also Allen, above n 136; M Scott Donald, "Regulating for fiduciary qualities of conduct" (2013) 7 *Journal of Equity* 142; Simone Degeling and Jessica Hudson, "Fiduciary obligations, financial advisers and FoFA" (2014) 32 *Company and Securities Law Journal* 527; Paul Latimer, "Protecting the best interests of the client" (2014) 29 *Australian Journal of Corporate Law* 8; Simone Degeling and Jessica Hudson, "Equitable monetary remedies against financial advisers who give 'advice about advice'" (2015) 33 *Company and Securities Law Journal* 166; Justice Ashley Black, 'Equitable and statutory regulation of conflicts of interests and duty - Presentation at UNSW Law School 10 May 2016', available at http://www.supremecourt.justice.nsw.gov.au/Documents/Publications/Speeches/2016%20Speeches/Black_20160510.pdf. Also of interest is the recent decision in *Torlonia v Wright* [2016] NSWSC 1139 (Brereton J) concerning a fiduciary relationship arising between an accountant and client.
154 *Grimaldi v Chameleon Mining NL (No 2)* (2012) 200 FCR 296; [2012] FCAFC 6 at [177] (Finn, Stone and Perram JJ).
155 *Daly v Sydney Stock Exchange Ltd* (1986) 160 CLR 371; (1986) 65 ALR 193; [1986] HCA 25 at CLR 385.

client and the stockbroker was fiduciary in those circumstances. The Court held that it was.[156] In particular, Brennan J said:

> Whenever a stockbroker or other person who holds himself out as having expertise in advising on investments is approached for advice on investments and undertakes to give it, in giving that advice the adviser stands in a fiduciary relationship to the person whom he advises. The adviser cannot assume a position where his self-interest might conflict with the honest and impartial giving of advice.

Whether a particular relationship or dealing makes the financial services firm a fiduciary depends on the nature of the service provided, and the circumstances in which it is provided. Where a financial service firm holds itself out as an expert on financial matters and undertakes to act in the client's interests[157] and not solely in its own interests in the provision of personal advice in relation to those matters, the relationship between the firm and its client has been found to be fiduciary in character.[158]

In *Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Ltd (No 4)*, Jacobson J said that a 'fiduciary relationship arises between a financial adviser and its client where the adviser holds itself out as an expert on financial matters and undertakes to perform a financial advisory role for the client'.[159] Two cases arising out of the sale of complex financial products to local councils prior the Global Financial Crisis in 2008, came to the same conclusion. The financial services firms that

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[156] See *Daly v Sydney Stock Exchange Ltd* (1986) 160 CLR 371; (1986) 65 ALR 193; [1986] HCA 25 at CLR 377 per Gibbs CJ; at CLR 385 per Brennan J.

[157] For example, the Code of Professional Practice of the Financial Planning Association of Australia includes, as Principle 1, that 'Placing the client's interests first is a hallmark of professionalism, requiring the financial planner to act honestly and not place personal and/or employer gain or advantage before the client's interests.' Financial Planning Association of Australia, *The Pillars of Our Profession: Code of Professional Practice* (July 2013) 6.

[158] See *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390 at 319; *Aequitas v Sparad No 100 Ltd (formerly Australian European Finance Corporation Ltd*) (2001) 19 ACLC 1006; [2001] NSWSC 14 at [301], [310] (Austin J); *Fletcher (as trustee of the Brian Fletcher Family Trust) v St George Bank Ltd (No 2)* [2011] WASC 277 at [116]. In *Addenbrooke Pty Ltd v Duncan (No 2)* (2017) 121 ACSR 406; [2017] FCAFC 76 at [624] (Gilmour and White JJ), the parties were 'in a conventional sharebroker-client relationship, with the broker being retained on a transaction by transaction basis and providing advice and recommendations from time to time which were usually followed by the client. It may be accepted that in this respect the two entities were in a fiduciary relationship... The evidence does not suggest, however, that SCE and Addenbrooke were in a continuing relationship of investment advisor and client'.

[159] *Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Ltd (No 4)* (2007) 62 ACSR 427; [2007] FCA 963 at [283].

dealt with the councils[160] were found to owe fiduciary duties to them in advising on and recommending the products.

In *Wingecarribee Shire Council v Lehman Bros Australia Ltd (in liq),*[161] Rares J described financial advisers as one of the 'well recognised categories' of fiduciary agents to which, in the absence of contractual or other modifications, the fiduciary obligations apply.

In similar circumstances, in *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5*),[162] Jagot J found that a financial services firm that had entered into formal agreements to provide investment advisory services to certain of its clients owed fiduciary duties to those clients because the firm had 'led [the client] to believe that it would act in their best interests in advising and making recommendations about financial products'. With certain other of its clients, with which the firm did not have formal investment advisory agreements, the firm had engaged in a course of conduct over time that her Honour considered took it beyond being a 'mere salesman' of the financial products in question; it 'knew the context in which the [clients] functioned and knew that the [clients] perceived [the firm] as acting in their interests and not [the firm's] sole interest'. In so doing the firm 'moved beyond the role of a mere salesman and acted as an investment adviser and thereby attracted to itself fiduciary duties'.

While it is tempting to read these observations as meaning that 'financial adviser' is now a recognised category of fiduciary under Australian law, the position is more nuanced. What matters is the nature of the undertaking made or given by the adviser and how that undertaking is reasonably understood and acted upon by the client. It is not enough to create a fiduciary relationship that the firm is a 'mere salesman' of a financial product; nor that it provides information or opinions or about particular financial products, or general advice about investments, corporate finance, or financial planning. The advice must be personal to the client; and the circumstances of the giving and receipt of that advice

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[160] The Councils were not households. Although they were wholesale clients, they were inexperienced in relation to the synthetic collateralised debt obligations (SCDOs) and other complex financial products.
[161] *Wingecarribee Shire Council v Lehman Bros Australia Ltd (in liq)* (2012) 301 ALR 1; [2012] FCA 1028 at [733].
[162] *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200 at [2306]; upheld on appeal *ABN Amro Bank NV v Bathurst Regional Council* (2014) 309 ALR 445; [2014] FCAFC 65 at [1063] – [1071]. The case concerned the rating, sale and purchase of a structured financial product known as a constant proportion debt obligation or CDPO.

must be such that the client would reasonably understand the adviser to be looking out for or motivated by the client's interest (rather than its own or another person's) in arriving at its recommendations. That said, the advice need not relate to the client's whole financial position or occur in the context of an ongoing professional relationship between the firm and the client; it is possible for a fiduciary relationship to arise in respect of particular advice given on a single occasion.[163]

If the parties have expressly stated that the relationship is not fiduciary in character, this will be a relevant consideration, although not necessarily conclusive.[164] In *ABN Amro*, Jacobson, Gilmour and Gordon JJ summarised the applicable principles in the following terms:

> (1) The "critical feature is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person".
>
> (2) It is the element of undertaking (from the point of view of the fiduciary) or obligation (for and on behalf of the beneficiary) that has the consequence that equity insists that the principal must act in the "interests of" or "for the benefit of" the beneficiary rather than in the principal's own interests.
>
> (3) Whether a fiduciary relationship exists in a particular case, and if so, the scope of that fiduciary relationship, are matters which depend critically upon the particular circumstances of the case.
>
> (4) The characteristics which define a fiduciary relationship cannot be exhaustively defined. It is inappropriate to treat the existence of a fiduciary obligation as being dependent upon whether the principal and beneficiary fall into a particular status relationship.
>
> (5) Similarly, whether a fiduciary relationship has come into existence does not depend upon the motivation or desire of one party to establish a relationship of trust or confidence. What matters is whether there is a relationship involving the requisite undertaking, determined as a matter of objective characterisation, rather than by having regard to the subjective expectations of the parties.[165]

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[163] See, for example, *Addenbrooke Pty Ltd v Duncan (No 2)* (2017) 121 ACSR 406; [2017] FCAFC 76. In *Daly v Sydney Stock Exchange Ltd* (1986) 160 CLR 371; (1986) 65 ALR 193; [1986] HCA 25 at CLR 377, Brennan J said, 'A fiduciary relationship in respect of a transaction may arise though there has been no anterior relationship between the parties to that transaction'.
[164] See *Australian Securities and Investments Commission* v *Citigroup Global Markets Australia Pty Ltd (No 4)* (2007) 160 FCR 35; [2007] FCA 963.
[165] Citations omitted. *ABN Amro Bank NV v Bathurst Regional Council* (2014) 309 ALR 445; [2014] FCAFC 65 at [1066].

If the relationship is fiduciary, then the adviser is 'under two proscriptive obligations imposed by equity. Those obligations are, unless the fiduciary has the informed consent of the person to whom they are owed, first, not to obtain any unauthorised benefit from the relationship and, secondly, not to be in a position where the interests or duties of the fiduciary conflict, or there is a real or substantial possibility they may conflict, with the interest of the person to whom the duty is owed'.[166] The fiduciary proscriptions are discussed in Chapter 5.

3.3 AFS licensee obligations

In the ordinary course an entity that carries on a financial services business (including a business of providing financial product advice) must hold an AFS licence issued by ASIC under Part 7.6 of the Corporations Act. The licensing requirements, which are linked to the statutory obligations imposed on AFS licensees by s 912A of the Corporations Act, are an important element in the legal framework. The AFS licence will specify the categories of financial services, in respect of the types of products and to the classes of client (retail and wholesale, or wholesale only), that the licensee may provide. In considering an application for a licence, ASIC tailors its requirements having regard to the authorisations sought.[167] From July 2016, it is possible for accountants giving advice in relation to SMSF to apply for a 'limited' AFS licence.[168]

The pattern of Part 7.6 is that ASIC must grant an applicant an Australian financial services licence if (and must not grant such a licence unless) the criteria in the s 913B(1) of the Corporations Act are met.

The licensing criteria include that 'ASIC has no reason to believe that the applicant is likely to contravene the obligations that will apply under section 912A if the licence is granted'.[169] As part of the licensing process, ASIC obtains information from the applicant to enable it to make an assessment as to whether there is any reason to believe that the

[166] *Wingecarribee Shire Council v Lehman Bros Australia Ltd (in liq)* (2012) 301 ALR 1; [2012] FCA 1028 at [732], referring to *Pilmer v Duke Group Ltd (in liq)* (2001) 207 CLR 165 at 197-198 [74], 199 [78]-[79].
[167] Australian Securities and Investments Commission, *Regulatory Guide 1 – AFS Licensing Kit: Part 1, Applying for and varying an AFS licence* (September 2017).
[168] Australian Securities and Investments Commission, *Information Sheet 216 – AFS licensing requirements for accountants who provide SMSF services* (May 2017). *Corporations Regulations 2001* (Cth) reg 7.8.12A and 7.8.12B.
[169] *Corporations Act 2001* (Cth) s 913A(1)(b). Until 1 July 2012, the relevant test was whether the applicant 'will not comply', rather than 'is likely to contravene'; the test was amended as part of FoFA.

applicant will not comply with these obligations.[170] This links the licence to the entity's capacity to meet its obligations under s 912A. These are that it must:

> (a) do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly; and
>
> (aa) have in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services as part of the financial services business of the licensee or the representative; and
>
> (b) comply with the conditions on the licence; and
>
> (c) comply with the financial services laws; and
>
> (ca) take reasonable steps to ensure that its representatives comply with the financial services laws; and
>
> (d) subject to [s 912A(4)] — have available adequate resources (including financial, technological and human resources) to provide the financial services covered by the licence and to carry out supervisory arrangements; and
>
> (e) maintain the competence to provide those financial services; and
>
> (f) ensure that its representatives are adequately trained, and are competent, to provide those financial services; and
>
> (g) if those financial services are provided to persons as retail clients — have a dispute resolution system complying with [s 912A(2)]; and
>
> (h) subject to [s 912A(5)] — have adequate risk management systems; and
>
> (j) comply with any other obligations that are prescribed by regulations made for the purposes of this paragraph.

[170] ASIC must also be satisfied that there is no reason to believe that any of the applicant's responsible officers are not of good fame and character, or if ASIC is not so satisfied, that the applicant's ability to provide the financial services covered by the licence would nevertheless not be significantly impaired. *Corporations Act 2001* (Cth) s 913B(4) sets out certain matters to which ASIC must have regard in considering whether there is any reason to believe that a person is not of good fame or character. 'Responsible officer' is defined for this purpose in s 9 of the Act as an officer who would perform duties in connection with the holding of the licence.

ASIC has issued extensive guidance on the general obligations of licensees.[171]

At present, an AFS licensee that contravenes s 912A of the Corporations Act is at risk of licensing action by ASIC. Under s 915C(1)(a) and (aa) of the Corporations Act, ASIC may suspend or cancel an AFS licence after a hearing if 'the licensee has not complied with their obligations under s 912A' or 'ASIC has reason to believe that the licensee is likely to contravene their obligations under s 912A'. However, there is no sanctioning mechanism – failure by a licensee to comply with s 912A is not an offence or a civil penalty provision and does not give a client a right to a remedy. The ASIC Enforcement Review Taskforce recently adopted as its preliminary position that provisions imposing general obligations on licensees should be civil penalty provisions.[172] This may reflect the difficulties ASIC faces in using its licensing powers to deter non-compliance, particularly against large licensees.

Efficiently, honestly and fairly

The licensee is required to 'do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly'. The emphatic drafting (necessary, rather than reasonable) suggests that if a representative does not provide advice 'efficiently, honestly and fairly' then the licensee has not met the statutory requirement.[173]

'Efficiently, honestly and fairly' is an omnibus standard. Justice Beach explained the standard in *Australian Securities and Investments Commission v Avestra Asset Management Ltd (in liq)* in the following terms:

> The "efficiently, honestly and fairly" standard is applied as a single, composite concept, rather than three discrete behavioural norms. The

[171] Australian Securities and Investments Commission, *Regulatory Guide 36 - Licensing: Financial product advice and dealing* (June 2016); Australian Securities and Investments Commission, *Regulatory Guide 104 - Licensing: Meeting your general obligations* (July 2015); Australian Securities and Investments Commission, *Regulatory Guide 105 - Licensing: Organisational competence* (June 2016); Australian Securities and Investments Commission, *Regulatory Guide 146 - Licensing: Training of financial product advisers* (July 2012); Australian Securities and Investments Commission, *Regulatory Guide 166 - Licensing: Financial resources* (September 2017); Australian Securities and Investments Commission, *Regulatory Guide 175 - Licensing: Financial product advisers—Conduct and disclosure* (November 2017); Australian Securities and Investments Commission, *Regulatory Guide 181 - Licensing: Managing conflicts of interest* (August 2004).

[172] Commonwealth of Australia, ASIC Enforcement Review, *Positions Paper 7: Strengthening Penalties for Corporate and Financial Sector Misconduct* (October 2017) [83].

[173] As noted, this does not expose the licensee to a penalty or give the client a remedy. Instead, a contravention of *Corporations Act 2001* (Cth) s 912A may be a basis for licensing action by ASIC.

> following principles are not in doubt …. First, the words “efficiently, honestly and fairly” entail that a person must go about their duties efficiently having regard to the dictates of honesty and fairness, honestly having regard to the dictates of efficiency and fairness, and fairly having regard to the dictates of efficiency and honesty. Second, the phrase connotes a requirement of competency in providing advice and in complying with relevant statutory obligations. Third, the word “efficient” entails that the person is adequate in performance and is competent. Fourth, the concept of honesty is looked at through the lens of commercial morality rather than through the lens of the criminal law.[174]

In *Australian Securities and Investments Commission v Cassimatis (No 8),* Edelman J concluded that contraventions by Storm Financial Limited of its statutory obligations to provide personal advice that met the (then) suitability requirement in s 945A of the Corporations Act ‘were sufficiently serious departures from reasonable standards of performance of advice that they involved a failure to ensure that the financial services covered by the licence were provided efficiently, honestly and fairly’.[175]

Conflicts management

Licensees must have in place adequate arrangements for the management of conflicts of interest. Section 912A(1)(aa) was introduced after FSR had commenced, and came into effect on 1 January 2005. ASIC’s regulatory guidance was issued in August 2004.[176] Licensees’ conflicts management obligations are discussed at length in Chapter 5.

Licence conditions

The licensee is required to comply with the conditions attached to the licence by ASIC. These include the (relevant) standard licence conditions set out in ASIC Pro Forma 209, the conditions in reg 7.6.04 of the Corporations Regulations,[177] and any other conditions imposed by ASIC under s 914A of the Corporations Act.[178]

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[174] *Australian Securities and Investments Commission v Avestra Asset Management Ltd (in liq)* (2017) 120 ACSR 247; [2017] FCA 497 at [191], referring to *Australian Securities and Investments Commission v Camelot Derivatives Pty Ltd (in liq)* (2012) 88 ACSR 206; [2012] FCA 414 at [69] and [70] (Foster J). See also *Australian Securities and Investments Commission v Cassimatis (No 8)* (2016) 338 ALR 209; [2016] FCA 1023 at [674].
[175] *Australian Securities and Investments Commission v Cassimatis (No 8)* (2016) 338 ALR 209; [2016] FCA 1023 at [673].
[176] Australian Securities and Investments Commission, *Regulatory Guide 181 - Licensing: Managing conflicts of interest* (August 2004).
[177] That is, to notify ASIC if any event occurs that may make a material adverse change to the financial position of the financial services licensee by comparison with its financial position at the

The licence conditions contain much of the nuts-and-bolts regulation. They specify the financial services that the licensee may provide, and permit the use of certain broker terms.[179] For entities authorised to provide financial product advice, they contain detailed requirements relating to compliance systems, training of representatives, financial resources, professional indemnity insurance, external dispute resolution arrangements, and retention of records.

Compliance with financial services laws

The licensee must comply with the financial services laws and 'take reasonable steps to ensure that its representatives comply with the financial services laws'. These are, relevantly:

> (a) a provision of this Chapter or of Chapter 5C, 5D, 6, 6A, 6B, 6C or 6D;
>
> (b) a provision of Chapter 9 as it applies in relation to a provision referred to in paragraph (a);
>
> (c) a provision of Division 2 of Part 2 of the ASIC Act;
>
> (d) any other Commonwealth, State or Territory legislation that covers conduct relating to the provision of financial services (whether or not it also covers other conduct), but only in so far as it covers conduct relating to the provision of financial services.[180]

Resources, competence and training

A licensee must have available adequate resources (including financial, technological and human resources) to provide the financial services covered by the licence and to carry out supervisory arrangements.[181] This includes meeting the financial requirements imposed by the licence conditions. All licensees are subject to base level financial requirements, and (depending on their particular authorisations) may have additional requirements imposed. The base level financial requirements are that the licensee must be able to pay all its debts as and when they become due and payable; and:

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time of the application for an AFS licence or as described in documents subsequently lodged with ASIC, and to notify ASIC if it becomes aware of a change of control.

[178] ASIC can add, vary or remove licence conditions during the currency of the licence, but only after a hearing, under *Corporations Act 2001* (Cth) s 914A

[179] Permission is required to use the terms stockbroker or sharebroker, futures broker, life insurance broker, general insurance broker, or insurance broker or insurance broking under *Corporations Act 2001* (Cth) s 923B(3).

[180] *Corporations Act 2001* (Cth) s 761A.

[181] This requirement does not apply to APRA regulated entities; instead they must satisfy APRA's prudential standards. *Corporations Act 2001* (Cth) s 912A(4).

- either have total assets that exceed total liabilities as shown in the licensee's most recent balance sheet lodged with ASIC and have no reason to suspect that the licensee's total assets would currently not exceed its total liabilities; or have adjusted assets that exceed adjusted liabilities calculated at the balance date shown in the licensee's most recent balance sheet lodged with ASIC and have no reason to suspect that the licensee's adjusted assets would currently not exceed its adjusted liabilities; and
- meet the cash needs requirement by complying with one of five options offered.[182]

A licensee must also 'maintain the competence to provide those financial services', and 'ensure that its representatives are adequately trained, and are competent, to provide those financial services'.

The training and competency standards for financial advisers are currently low;[183] recently enacted legislative changes to lift industry standards (discussed in Annexure B) do not come into full effect until 2024. During the period being examined by the Royal Commission, the competency and training requirements were set by ASIC Regulatory Guide 146.[184] The standard AFS licence conditions relating to training are:

> The licensee must for any natural person who provides financial product advice to retail clients on behalf of the licensee (including the licensee if he or she is a natural person):
>
> (a) identify the tasks and functions that person performs on behalf of the licensee; and
>
> (b) determine the appropriate knowledge and skills requirements required to competently perform those tasks and functions; and
>
> (c) implement procedures for continuing training.
>
> The licensee must ensure that any natural person who provides financial product advice to retail clients on behalf of the licensee (including the licensee if he or she is a natural person):

[182] Australian Securities and Investments Commission, *Pro Forma 209 Australian financial services licence conditions*, condition 13 (September 2017 version).
[183] See, for example, Adele Ferguson and Ben Butler "Cheating rife in financial planning" *The Sydney Morning Herald* 16 August 2014, reporting that 'Completion of an eight-day diploma known as RG146 is all it takes to qualify as a financial planner in Australia. No higher school education is required, tertiary education, work experience or professional accreditation'. Available at https://www.smh.com.au/business/banking-and-finance/cheating-rife-in-financial-planning-20140815-104gkn.html.
[184] Australian Securities and Investments Commission, *Regulatory Guide 146 - Licensing: Training of financial product advisers* (July 2012).

> (a) has completed training courses at an appropriate level that are or have been approved by ASIC in writing that are relevant to those functions and tasks; or
>
> (b) has been individually assessed as competent by an assessor that is or has been approved by ASIC in writing; or
>
> (c) in respect of financial product advice on basic deposit products and facilities for making non-cash payments that are related to a basic deposit product, has completed training courses that are or have been assessed by the licensee as meeting the appropriate level that are relevant to those functions and tasks.[185]

The training standards are described in ASIC Regulatory Guide 146 in the following terms:

> The training standards are sets of knowledge and (in some cases) skill requirements that must be satisfied, at either the Tier 1 or Tier 2 education level, by advisers before they give advice. The Tier 1 education level is broadly equivalent to the 'Diploma' level under the Australian Qualifications Framework and the Tier 2 education level is broadly equivalent to the 'Certificate III' level under the Australian Qualifications Framework.
>
> The knowledge and skill requirements and educational levels vary depending on the adviser's advice activities. That is, they vary depending on: (a) whether the adviser gives general or personal advice; and (b) what products the adviser gives advice on. The knowledge requirements are set out in Appendix A and the skill requirements are set out Appendix B.[186]

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[185] Australian Securities and Investments Commission, *Pro Forma 209 Australian financial services licence conditions*, conditions 6 and 7 (September 2017 version). The latter condition does not apply to 'a natural person who is a customer service representative and who provides financial product advice derived from a script approved by a natural person who complies with paragraphs 7(a), (b) and (c) ("qualified person") or under the direct supervision of a qualified person present at the same location; or a natural person who is a para-planner or trainee adviser and who provides advice under the direct supervision of a qualified person who is, in addition to the licensee, responsible for ensuring that any financial product advice that is provided by the para-planner or trainee adviser for which a Statement of Advice must be given, is reflected in a Statement of Advice that has been reviewed by the qualified person before the Statement of Advice is given, to ensure that the Statement of Advice would comply with all the requirements of the Act and managing and leading any verbal explanation of the financial product advice to the client, where the licensee has established procedures to ensure that the natural person does not provide financial product advice to retail clients on behalf of the licensee, other than in the manner specified in this paragraph, and the licensee monitors whether or not those procedures are effective'. It also does not apply 'in relation to financial product advice given to retail clients in advertising to which section 1018A applies, provided that [the] licence authorises the provision of financial product advice and a responsible officer of the licensee approves such advertising before its publication or dissemination to retail clients'; to financial product advice 'for which there is an exemption under the Act from the obligation to hold a licence'.

[186] Australian Securities and Investments Commission, *Regulatory Guide 146 - Licensing: Training of financial product advisers* (July 2012) [RG 146.6] – [RG 146.7].

In *Avoca Consultants Pty Ltd v Millennium3 Financial Services Pty Ltd*, Barker J held that the obligation of an AFS licensee to ensure that its representatives are adequately trained, read in combination with the obligation in s 912A(1)(ca), and 'the general objectives of Ch 7 of the [Act] … the tightening of the law governing the provision of financial services, and the rigorous licensing system [in Chapter 7 of the Act] … strongly suggests the holder of an AFSL should undertake a continuing training program that is calculated to produce competent representatives or maintain their level of competence'.[187]

3.4 Conduct of business rules

Part 7.8 contains various conduct of business rules, including rules relating to dealing with client money and property and to the execution of client orders, along with the requirements relating to licensees' financial records, financial statements and audit. These derive from the old securities industry laws, themselves a product of the recommendations of the Rae Committee in the 1970s.[188]

This part also includes a general prohibition on a licensee engaging in unconscionable conduct, in s 991A(1) of the Corporations Act. It it is that 'a financial services licensee must not, in or in relation to the provision of a financial service, engage in conduct that is, in all the circumstances, unconscionable'. There is some overlap with the unconscionability provisions in the ASIC Act, discussed in Section 3.5 below, but they are not identical.

3.5 ASIC Act provisions

Part 2, Division 2 of the ASIC Act is headed 'Unconscionable Conduct and Consumer Protection in Relation to Financial Services', but its coverage is not limited to consumer transactions.

The Part was introduced into the predecessor legislation in 1998, following the recommendation of the Wallis FSI that ASIC be the responsible regulator for conduct in the financial sector, rather than the ACCC. The intersection between the regime administered by ASIC and the (now) Australian Consumer Law administered by the ACCC and the state and territory fair trading bodies is complicated, but the intention is that ASIC is the

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[187] *Avoca Consultants Pty Ltd v Millennium3 Financial Services Pty Ltd* (2009) 179 FCR 46 at [342] – [346]; *Australian Securities and Investments Commission v NSG Services Pty Ltd* [2017] FCA 345 at [31] (Moshinsky J).

[188] Commonwealth of Australia, Senate Select Committee on Securities and Exchanges, *Australian Securities Markets and their Regulation* (1974).

responsible agency in relation to financial services.[189] Some sections of the ASIC Act overlap imperfectly with similar provisions in Chapter 7 of the Corporations Act, for example the sections dealing with unconscionability and misleading or deceptive conduct.[190]

In the advice context, key provisions include the prohibitions relating to unconscionable conduct, misleading or deceptive conduct (subject to an important carve-out in respect of personal advice given to retail clients), and false or misleading representations, and the implied warranties in consumer contracts. This Part also contains the law on unfair contracts.

Unconscionable conduct

Part 2 Division 2 Subdivision C of the ASIC Act prohibits certain forms of unconscionable conduct. There are three relevant provisions: ss 12CA, 12CB and 12CC. Section 12CA applies to any conduct engaged in, in trade or commerce, in relation to financial services; it prohibits conduct that is 'unconscionable within the meaning of the unwritten law, from time to time, of the States and Territories'. Sections 12CB and 12CC, as amended in 2011 to unify the consumer and business-related provisions, apply to conduct engaged in, in trade or commerce, in connection with the supply or possible supply, or acquisition or possible acquisition, of financial services to or from a person other than a listed public company.

Section 12CB prohibits 'conduct that is, in all the circumstances, unconscionable'.[191] It includes interpretative principles, among them in s 12CB(4)(b):

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[189] To the extent that the Australian Consumer Law is part of the law of the Commonwealth, it does not apply in relation to financial services and financial products: see *Competition and Consumer Act 2011* (Cth) ss 131 and 131A. Insofar as it is state law, it continues to apply: *Fair Trading Act 1987* (NSW) Pt 3; *Fair Trading Act 1999* (Vic) Pt 2; *Fair Trading Act 1989* (Qld) Pt 3; *Fair Trading Act 1987* (SA) Pt 3; *Fair Trading Act 2010* (WA); *Australian Consumer Law (Tasmania) Act 2010* (Tas); *Fair Trading (Australian Consumer Law) Act 1992* (ACT); *Consumer Affairs and Fair Trading Act* (NT) Pt 4.

[190] *Corporations Act 2001* (Cth) s 991A and *Australian Securities and Investments Commission Act 2001* (Cth) ss 12CA, 12CB and 12CC; *Corporations Act 2001* (Cth) s 1041H and *Australian Securities and Investments Commission Act 2001* (Cth) s 12DA. In *Wingecarribee Shire Council v Lehman Bros Australia Ltd (in liq)* (2012) 301 ALR 1; [2012] FCA 1028 at [948] Rares J said, 'Of course, each Act has a myriad of complex definitions of what is a financial product or a financial service or are financial services…. Since the end result of this legislative morass seems to be the same, it is difficult to discern why the public, their lawyers (if they can afford them) and the courts must waste their time turning up and construing which of these statutes applies to the particular circumstance. Here, should it make any difference whether Grange was alleged to have engaged in conduct in relation to "financial services" (s 12DA(1)) or "a financial product or a financial service" (s 1041H(1))? Why is there a difference? Why does a court have to waste its time wading through this legislative porridge to work out which one or ones of these provisions apply even though it is likely that the end result will be the same?'

> … it is the intention of the Parliament that … this section is capable of applying to a system of conduct or pattern of behaviour, whether or not a particular individual is identified as having been disadvantaged by the conduct or behaviour.

Section 12CC sets out a number of factors to which a court may have regard in determining whether conduct is unconscionable for this purpose, including matters such as the relative strengths of the bargaining positions of the supplier and the customer.

The term 'unconscionable' is not defined in the ASIC Act. It is to be given its ordinary meaning, being something done not in good conscience and that which is irreconcilable with what is right or reasonable. In *Tonto Home Loans Australia Pty Ltd v Tavares*, Allsop P said that:

> Aspects of the content of the word 'unconscionable' include the following: the conduct must demonstrate a high level of moral obloquy on the part of the person said to have acted unconscionably; the conduct must be irreconcilable with what is right or reasonable; … the concept of unconscionable in this context is wider than the general law and the provisions are intended to build on and not be constrained by cases at general law and equity; the statutory provisions focus on the conduct of the person said to have acted unconscionably. It is neither possible nor desirable to provide a comprehensive definition. The range of conduct is wide and can include bullying and thuggish behaviour, undue pressure and unfair tactics, taking advantage of vulnerability or lack of understanding, trickery or misleading conduct. A finding requires an examination of all the circumstances. [192]

In *Australian Competition and Consumer Commission v Lux Distributors Pty Ltd*, the Full Federal Court said:

> The task of the Court is the evaluation of the facts by reference to a normative standard of conscience. That normative standard is permeated with accepted and acceptable community values. In some contexts, such values are contestable. Here, however, they can be seen to be honesty and fairness in the dealing with consumers. The content of those values is not solely governed by the legislature, but the legislature may illuminate, elaborate and develop those norms and values by the act of legislating, and thus standard setting. The existence of State legislation directed to elements of fairness is a fact to be taken into account. It assists the Court in appreciating some

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[191] The language in *Australian Securities and Investments Commission Act 2001* (Cth) s 12CB reflects that in *Corporations Act 2001* (Cth) s 991A, which applies to conduct of a licensee in or in relation to the provision of a financial service.

[192] *Tonto Home Loans Australia Pty Ltd v Tavares* (2011) 15 BPR 29,699; [2011] NSWCA 389 at [291], cited with approval by Gordon J in *Paciocco v Australia and New Zealand Banking Group Ltd* (2014) 309 ALR 249; [2014] FCA 35 at [283] (citations omitted).

> aspects of the publicly recognised content of fairness, without in any way constricting it … These laws … reinforce the recognised societal values and expectations that consumers will be dealt with honestly, fairly and without deception or unfair pressure. These considerations are central to the evaluation of the facts by reference to the operative norm of required conscionable conduct.[193]

The notion of 'unconscionability' and the various statutory prohibitions on unconscionable conduct were explored at length in the bank fees litigation.[194] Justice Gageler said that the question to be answered is whether conduct is:

> … objectively to be characterised as 'unconscionable' according to the ordinary meaning of that term, requiring as it does a 'high level of moral obloquy' on the part of the person said to have acted unconscionably.[195]

The answer to that question turns on a consideration of that conduct in the context of what s 12CC(1) (previously, s 12CB(1)) describes as all the circumstances; 'where any one or more of those matters existed in respect of particular conduct, each of those extant matters was to form part of the totality of the circumstances mandatorily to be taken into account for the purpose of determining the statutory question posed by s 12CB(1)'.[196]

For conduct to be characterised as unconscionable, 'it must demonstrate something more than a mere tendency to mislead. The requirements fall short of a necessity to prove actual dishonesty. It is sufficient that there be a sufficient deviation from rectitude or right practice as to justify the epithet of "unconscionable".'[197]

Misleading or deceptive conduct

Section 12DA of the ASIC Act provides that 'a person must not, in trade or commerce, engage in conduct in relation to financial services that is misleading or deceptive or is likely to mislead or deceive'. Its operation in connection with financial advice overlaps with

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193 *Australian Competition and Consumer Commission v Lux Distributors Pty Ltd* [2013] FCAFC 90 at [23] (Allsop CJ, Jacobson and Gordon JJ)

194 *Paciocco v Australia and New Zealand Banking Group Ltd* (2014) 309 ALR 249; [2014] FCA 35 at [281]–[285]; *Paciocco v Australia and New Zealand Banking Group Ltd* (2015) 236 FCR 199; [2015] FCAFC 50 at [250]–[306]; [402] – [406]; *Paciocco v Australia and New Zealand Banking Group Ltd* (2016) 333 ALR 569; [2016] HCA 28 at [185] – [191]; [288] – [295]

195 *Paciocco v Australia and New Zealand Banking Group Ltd* (2016) 333 ALR 569; [2016] HCA 28 at [185]–[188], referring to *Attorney General (NSW) v World Best Holdings Ltd* (2005) 63 NSWLR 557 at 583.

196 *Paciocco v Australia and New Zealand Banking Group Ltd* (2016) 333 ALR 569; [2016] HCA 28 at [189].

197 *Australian Securities and Investments Commission v Wealth & Risk Management Pty Ltd (No 2)* [2018] FCA 59 at [116] (Moshinsky J); see also *Australian Securities and Investments Commission v Kobelt* [2016] FCA 1327 at [216]–[226].

s 1041H of the Corporations Act, discussed in Section 3.6 below. If a client suffers loss or damage as a result of a contravention of s 12DA, the client has a remedy against the person and any person involved in the contravention under s 12GF of the ASIC Act.

The application of s 12DA and its analogues[198] in relation to financial product advice is curtailed. This is because, by virtue of s 12DA(1A)(b), misleading or deceptive conduct 'in relation to a disclosure document or statement within the meaning of s 953A of the Corporations Act' does not contravene 12 DA(1).[199] The relevant documents and statements are:

- a Financial Services Guide (FSG); or
- a Supplementary FSG; or
- a Statement of Advice (SoA); or
- information, a statement or a copy of a record required by subsection 941C(5) or (7), 941D(2),946AA(5), 946B(3), (6) or (8) or 946C(2).

The effect of the carve-out is that, if a wholesale client receives written financial product advice that is misleading or deceptive, the client has a right of action under s 12DA of the ASIC Act and its analogues,[200] but if a retail client receives an SoA that is misleading or deceptive it may not. Instead, a retail client's right of action arises under s 953B(1) of the Corporations Act and the person providing the advice can rely on the defence in s 953B(6) if 'the person took reasonable steps to ensure that the disclosure document or statement would not be defective'.[201] That said, in a case involving poor advice about life insurance given in an SoA, the Court of Appeal in New South Wales found that the licensee contravened s 12DA of the ASIC Act and s 1041H of the Corporations Act in relation to the financial product (the life policy) and the financial service (described as the 'Statement of Advice'), seemingly without considering the carve-out.[202]

[198] That is, *Corporations Act 2001* (Cth) s 1041H and *Australian Consumer Law* s 18.
[199] *Corporations Act 2001* (Cth) ss 1041H(3) and 1041K.
[200] In the local council cases, the plaintiff successfully sued the investment banks for misleading or deceptive conduct in recommending investment in the complex products: see *Wingecarribee Shire Council v Lehman Bros Australia Ltd (in liq)* (2012) 301 ALR 1; [2012] FCA 1028; *ABN Amro Bank NV v Bathurst Regional Council* (2014) 309 ALR 445; [2014] FCAFC 65.
[201] 'Defective' is defined in *Corporations Act 2001* (Cth) s 953A(1) and includes if there is a misleading or deceptive statement in the document or an omission of information that is required by Corporations Act 2001 (Cth) Pt 7.7.
[202] *Commonwealth Financial Planning Ltd v Couper* [2013] NSWCA 444 at [104].

In order for a client to establish a claim of misleading or deceptive conduct, there is no need for the client to show that that the representation or conduct was intentionally misleading or was made negligently. The legal principles are well established:

> Conduct is misleading or deceptive if it has a tendency to lead a person into error: *Campbell v Backoffice Investments Pty Ltd* (2009) 238 CLR 304 (*Campbell*) at [25] per French CJ. Conduct is likely to mislead or deceive if there is a real or not remote chance or possibility of it doing so: *Global Sportsman Pty Ltd v Mirror Newspapers Pty Ltd* (1984) 2 FCR 82 at 87. Whether conduct is, or is likely to be, misleading or deceptive is determined objectively: *Butcher v Lachlan Elder Realty Pty Ltd* (2004) 218 CLR 592 at [109] per McHugh J, approved in *Campbell* at [102]. Further, in assessing the effect of conduct on a class of persons such as consumers, who may range from the gullible to the astute, the Court must consider whether the 'ordinary' or 'reasonable' members of that class would be misled or deceived: *Google Inc v Australian Competition and Consumer Commission* (2013) 249 CLR 435 at [7].[203]

There is often a link between advice that is negligently given, and advice that is misleading or deceptive.[204] Where a person makes a representation with respect to a future matter and the person does not have reasonable grounds for making the representation, the representation is taken to be misleading.[205]

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[203] *Australian Securities and Investments Commission v Wealth & Risk Management Pty Ltd (No 2)* [2018] FCA 59 at [116] (Moshinsky J).

[204] See, for example, *Jordan v HLB Mann Judd Wealth Management (NSW) Pty Ltd* (2013) 93 ACSR 344; [2013] FCA 315 at [126] – [128] (Foster J) and *Jamieson v Westpac Banking Corporation* (2014) 283 FLR 286; (2014) 98 ACSR 63; [2014] QSC 032, on appeal *Westpac Banking Corporation v Jamieson* (2015) 104 ACSR 657; [2015] QCA 050. Helpfully, Applegarth J summarises the basis on which the bank was found liable at first instance for poor advice, at [35] – [41]. The 'bank was in breach of contract and negligent with respect to the [MIS investment] and associated loans in three respects. Its conduct in that regard also amounted to conduct that was misleading or deceptive or likely to mislead or deceive in contravention of s 12DA(1) of the ASIC Act. First, the statement of advice failed to mention the capitalised interest assistance loan or to describe more accurately its operation, and in particular that interest would be payable on the capitalised interest in a significant amount…. The second basis of the bank's liability concerned its statement of risk, namely that "we put less than 10% of your overall net wealth at risk of loss". The primary judge found that the total sum at risk was much more than this and that the statement of advice should not have made such an unqualified statement. The third respect in which the bank was liable was in failing to provide to [the client] the full terms and conditions of the Macquarie structured investment loan, including the capitalised interest assistance loan and the product disclosure statement (PDS) for the [MIS investment]. Investment in the [MIS investment] and the associated loans was said by the primary judge to be "a highly complex contractual arrangement based on investments in derivative financial products". It was incumbent upon the bank, in recommending such a complex product, to provide copies of the relevant documents so that the risks and benefits could be assessed by the client'.

[205] *Corporations Act 2001* (Cth) s 769C; *Australian Securities and Investments Commission Act 2001* (Cth) s 12BB.

Where a claim relates to advice, the representation made may often be characterised as an opinion. In *Campbell v Backoffice Investments Pty Ltd*, French CJ said:

> A statement of opinion may be a statement with respect to a future matter. It may take the form of a prediction. A forward estimate relating to the financial results of a business is a class of prediction. In strict logic there may be some category overlap between opinions and statements of fact. Opinions may carry with them one or more implied representations according to the circumstances of the case. There will ordinarily be an implied representation that the person offering the opinion actually holds it. Other implied representations may be that the opinion is based upon reasonable grounds, which may include the representation that it was formed on the basis of reasonable enquiries. In the case of a person professing expertise or particular skill or experience the opinion may carry the implied representation that it is based upon his or her expertise, skill or experience.[206]

In *Australian Securities and Investments Commission v Cassimatis (No 8)*, ASIC alleged that certain statements contained in the Storm Financial SoA were misleading for the purposes of s 1041E of the Corporations Act, discussed in Section 3.6 below. This included a statement that 'Storm had recommended a process that would help the client to achieve his or her goals'. Justice Edelman considered the statement to be 'in part, promissory. A promise of something in the future which is not fulfilled is not, by itself, a false or misleading statement. This is because a promise that something will happen in the future is not false or misleading at the time it is made merely because that future event does not come to pass'. The advice given in the relevant SoA was found by his Honour (in obiter) to have breached the suitability rule in the former s 945A of the Corporations Act. But the representation was not misleading, because 'First, there is no basis to conclude that the relevant individual at Storm who gave or approved the advice did not honestly believe that it was capable of helping the client. Secondly, ASIC did not plead that the … statement carried any implied representation that the advice was reasonable or appropriate and, *for that reason*, was capable of assisting the investor to achieve his or her goals'.[207]

Implied warranties

Section 12ED of the ASIC Act contains two implied warranties, that cannot be excluded by agreement. The first warranty is implied into 'every contract for the supply of financial

[206] *Campbell v Backoffice Investments Pty Ltd* (2009) 238 CLR 304; (2009) 73 ACSR 1; [2009] HCA 225 at [33] (French CJ).
[207] *Australian Securities and Investments Commission v Cassimatis (No 8)* (2016) 338 ALR 209; [2016] FCA 1023 at [661] – [664].

services by a person to a consumer[208] in the course of a business'. It is that the services will be rendered with due care and skill, and any materials supplied in connection with those services will be reasonably fit for the purpose for which they are supplied.

In *ABN Amro Bank NV v Bathurst Regional Council,* s 12ED was used to imply certain warranties into the mandate letter given by a client to a bank in connection with the client's investment in complex financial products, including that the bank would render its services with due care and skill; that it would structure and arrange the products so that they would be reasonably fit for the purpose of being held by client (a body responsible for investing on behalf of certain local councils) or the local councils to whom the client might sell the notes as investments with a high degree of security commensurate with a AAA rating; and that the bank would structure and arrange the notes so that they might reasonably be expected to have a degree of security commensurate with a AAA rating. In this case it was not disputed that the client was a consumer.[209]

The second warranty is in s 12ED(2) and applies if a person supplies financial services to a consumer in the course of a business and 'the consumer, expressly or by implication, makes known to the person … any particular purpose for which the services are required; or … the result that he or she desires the services to achieve'. When this occurs 'there is an implied warranty that the services supplied under the contract for the supply of the services, and any materials supplied in connection with those services, will be reasonably fit for that purpose or are of such a nature and quality that they might reasonably be expected to achieve that result, except if the circumstances show that the consumer does not rely, or that it is unreasonable for him or her to rely, on the person's skill or judgment'.

In *Jamieson v Westpac Banking Corporation*, the clients had made known to the financial adviser their investment goals, that 'the financial plan to be prepared by him should take into account that Mr Jamieson wanted to protect his assets and grow his wealth, did not want to risk on any investment more than 10% of the net asset worth of him and his wife, wanted to improve his tax position and wanted to make best use of his employee share options'. However, 'the statements that Mr Jamieson wanted to protect his assets and grow his wealth did not amount to a statement of purpose of a kind which supports the alleged

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[208] See above n 137 for the definition of consumer.
[209] *ABN Amro Bank NV v Bathurst Regional Council* (2014) 224 FCR 1; [2015] FCAFC 65 at [936] – [945].

implied warranties as to protection of assets. Aspirational statements about a proposed course of investment action, if successful or unsuccessful, are not such a purpose'.[210]

3.6 Corporations Act Part 7.10

A person who provides financial product advice is also subject to Part 7.10 of the Corporations Act, which prohibits certain types of undesirable conduct in relation to financial products, including various forms of misleading statements and representations.

Section 1041H of the Corporations Act deals with misleading or deceptive conduct; it is the analogue of s 12DA of the ASIC Act and s 18 of the Australian Consumer Law. As with those provisions, it does not apply to conduct 'in relation to a disclosure document or statement within the meaning of s 953A of the Corporations Act' – that is, an FSG or an SoA.[211] It is that 'a person must not, in this jurisdiction, engage in conduct in relation to a financial product or financial service, that is misleading or deceptive or likely to mislead or deceive'.

It is possible that defective advice, in addition to contravening either the specialist liability regime in s 953A of the Corporations Act (for advice contained in an SoA) or the general prohibitions on misleading or deceptive conduct (for other advice), may also contravene s 1041E, s 1041F or s 1041G of the Corporations Act if it is dishonestly or recklessly given. In each case contravention is a criminal offence. It may also give rise to civil liability under s 1041I of the Corporations Act.

Dissemination of false or misleading information: s 1041E

Section 1041E prohibits the making of a statement or the dissemination of information (whether in the jurisdiction or elsewhere) that, in either case, is false in a material particular or materially misleading, if it is:

- likely to induce persons in the jurisdiction to apply for financial products;
- likely to induce persons in the jurisdiction to dispose of or acquire financial products; or
- likely to have the effect of increasing, reducing, maintaining or stabilising the price for financial products traded on a financial market.

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[210] *Jamieson v Westpac Banking Corp* (2014) 283 FLR 286; (2014) 98 ACSR 63; [2014] QSC 032 at [93] - [95] (Jackson J).
[211] *Corporations Act 2001* (Cth) s 1041H(3).

Conduct contravenes s 1041E only if, when making the statement or disseminating the information, the maker or the person disseminating, either:

- does not care whether the statement or information is true or false; or
- knows or ought reasonably to have known that the statement or information is false in a material particular or materially misleading.

The potential application of s 1041E to statements in an FSG and SoA recommending that clients acquire particular products is considered by Edelman J in *Australian Securities and Investments Commission v Cassimatis (No 8)*.[212] In particular, his Honour concluded that advice of this kind is intended to induce the clients to acquire financial products.

Improperly inducing dealing: s 1041F

Section 1041F of the Corporations Act imposes civil and criminal liability on any person inducing others to deal in financial products by improper means. It provides that:

> A person must not, in this jurisdiction, induce another person to deal in financial products:
>
> (a) by making or publishing a statement, promise or forecast if the person knows, or is reckless as to whether, the statement is misleading, false or deceptive; or
>
> (b) by a dishonest concealment of material facts; or
>
> (c) by recording or storing information that the person knows to be false or misleading in a material particular or materially misleading if:
>
> > (i) the information is recorded or stored in, or by means of, a mechanical, electronic or other device; and
> >
> > (ii) when the information was so recorded or stored, the person had reasonable grounds for expecting that it would be available to the other person, or a class of persons that includes the other person.

[212] *Australian Securities and Investments Commission v Cassimatis (No 8)* (2016) 338 ALR 209; [2016] FCA 1023 at [623] – [641].

Dishonest conduct: s 1041G

Section 1041G prohibits dishonest conduct. It provides that a person 'must not, in the course of carrying on a financial services business in the jurisdiction, engage in dishonest conduct in relation to a financial product or financial service'. The test of dishonesty is 'dishonest according to the standards of ordinary people and known by the person to be dishonest according to the standards of ordinary people'. Accordingly it reflects the *Ghosh* test for dishonesty, rather than the *Peters* test preferred by the High Court of Australia.[213]

3.7 Additional Part 7.6 requirements – retail clients

The obligations discussed in Section 3.1 – 3.6 apply generally in relation to the provision of financial services, including financial product advice. This section sets out additional requirements that are imposed on the licensee when it deals retail clients, relating to dispute resolution arrangements and professional indemnity insurance.

Dispute resolution arrangements

If the licensee provides financial services to retail clients, it must have a dispute resolution system complying with s 912A(2) of the Corporations Act. That requires:

- an internal dispute resolution procedure that complies with standards, and requirements, made or approved by ASIC and covers complaints against the licensee made by retail clients in connection with the provision of all financial services covered by the licence; and
- until 2018, membership of one or more external dispute resolution schemes approved by ASIC covering complaints (other than complaints that may be dealt with by the Superannuation Complaints Tribunal) against the licensee made by retail clients in connection with the provision of all financial services covered by the licence.[214]

[213] *R v Ghosh* [1982] 2 All ER 689; *Peters v R* [1998] 192 CLR 493. The *Peters* test is objective: dishonest according to the standards of ordinary, decent people.

[214] From 2018, the requirement is that the licensee must be a member of the AFCA scheme. The AFCA scheme is 'the external dispute resolution scheme for which an authorisation under Part 7.10A is in force', operated by the Australian Financial Complaints Authority. The Authority was established in 2017 following the recommendations of the Ramsay review of dispute resolution: see Commonwealth of Australia, The Treasury, *Review of the Financial System External Dispute Resolution and Complaints Framework* (April 2017) (Ramsay Review).

Compensation arrangements

Section 912B of the Corporations Act requires that licensees must have arrangements for compensating retail clients for losses they suffer as a result of a breach by the licensee or its representatives of their obligations in Chapter 7. The arrangements must either satisfy the requirement in reg 7.6.02AAA of the Corporations Regulations that licensees obtain professional indemnity insurance cover that is adequate considering the nature of the licensee's business and its potential liability for compensation claims, or be alternative arrangements approved by ASIC. The Corporations Regulations also provide exemptions from the requirements for some licensees that are regulated by APRA or related to an entity regulated by APRA.

Despite this requirement, the professional indemnity insurance cover held by some licensees is limited.[215]

3.8 Disclosure requirements for retail clients - FSG and general advice warning

When financial services are provided to retail clients, the person providing the service may be required to give the client an FSG, although this is rarely required for general advice. When the client receives general advice, the general advice warning must be given.

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As with much of Chapter 7 of the Corporations Act, the provisions determining whether (and if so when) a FSG must be provided are lengthy and detailed and close attention the Regulations and to ASIC instruments is required.[216] It is usually required when the client is to be given personal advice but may not always be required for general advice.

[215] Australian Securities and Investments Commission, *Regulatory Guide 126 - Compensation and insurance arrangements for AFS licensees* (August 2017); Australian Securities and Investments Commission *Report 459 Professional indemnity insurance market for AFS licensees providing financial product advice* (December 2015); J K Morgan and P F Hanrahan 'Professional indemnity insurance: regulating professionals and protecting consumers' (2017) 40 *University of New South Wales Law Journal* 353. The cover available would not always meet the Professional Standards Councils *Policy Statement on Professional Indemnity Insurance*, available at http://www.psc.gov.au/sites/default/files/Professional%20Indemnity%20Insurance.pdf.

[216] See *Corporations Act 2001* (Cth) Pt 7.7, Div 2, Subdiv A and *Corporations Regulations 2001* (Cth) reg 7.7.02 and 7.7.02A.

The FSG will either be prepared and provided by:

- the authorised representative,
- the AFS licensee if it is providing the service directly or through a representative who is not an authorised representative.[217]

If an FSG is required, it must be provided to the client as soon as practicable after it becomes apparent to the providing entity that a financial service will be or is likely to be provided to the client, and in any event before that financial service is provided.[218] For example, an FSG might be provided to a client when it attends its first meeting with an adviser. If a series of financial services are provided to a client, an FSG only needs to be given when those services are first provided unless the information in it ceases to be accurate (in which case an updated FSG or Supplementary FSG must be given). If a client expressly instructs that it requires the financial service to be provided immediately or by a specified time, and it is not reasonably practicable to give the FSG to the client before the service is provided, then the providing entity is required to give a statement of specified information to the client instead.[219]

The content of an FSG provided to a retail client by a financial services licensee is specified in s 942B of the Corporations Act. The FSG must include:

- the name and contact details of the financial services licensee, and any special instructions about how the client may provide instructions to the financial services licensee;[220]
- information about the kinds of financial services that the financial services licensee is authorised to provide under its licence, and the kinds of financial products to which those services relate;[221]
- information about who the financial services licensee acts for when providing the relevant services.[222] This provision might specify, for example, whether a licensee

[217] The authorised representative or the AFS licensee is referred to as the 'providing entity'.
[218] *Corporations Act 2001* (Cth) s 941D(1).
[219] *Corporations Act 2001* (Cth) s 941D(2), containing the information required to be in the FSG by s 942B(2)(e), (f) and (i) or s 942(f), (g) and (i), including information about remuneration or other benefits and information about any associations or relationships with product issuers capable of creating conflicts of interest, and such other information which would be required to be in the FSG as is particularly relevant to the financial service to be provided. This must be followed with the full FSG within five days or sooner if practicable.
[220] *Corporations Act 2001* (Cth) s 942B(2)(a)–(b).
[221] *Corporations Act 2001* (Cth) s 942B(2)(c).
[222] *Corporations Act 2001* (Cth) s 942B(2)(d).

acts for the insured or the insurer in arranging policy cover. In the case of a licensee that is authorised to use the term 'insurance broker' under s 923B, the FSG would typically include information that the licensee acts on the client's behalf;

- information about the remuneration (including commission) or other benefits which the financial services licensee, a related body corporate, or any of the licensee's or a related body corporate's directors or employees, or their associates will receive in respect of, or which is attributable to, the provision of the relevant services;[223]
- information about any associations or relationships between the financial services licensee or any related body corporate and the issuers of any financial products which might reasonably be expected to be capable of influencing the financial services licensee in providing the relevant services;[224]
- in the case of a financial services licensee that provides market-related advice (within the scope of s 946B(1)), a statement to the effect that the client may request a record of that advice and particulars of how the client may request such a record. Any limitation in those particulars on the time within which the client may request such a record must be consistent with any applicable requirements in the regulations or, if there are no such applicable requirements, must be such as to allow the client a reasonable opportunity to request a record of the advice.[225] If an FSG includes a statement to this effect, and the client is provided with execution-related advice to which that statement applies and has not already been provided with a record of that advice, the licensee must comply with a request for a record of that advice;[226]
- information about the dispute resolution system that covers complaints by persons to whom the financial services licensee provides financial services, and about how that system may be accessed;[227]
- if the financial services licensee acts under a binder in providing any of the services, a statement that identifies the services provided under the binder, states that they are provided under a binder and explains the significance of the services being provided under a binder;[228]

[223] *Corporations Act 2001* (Cth) s 942B(2)(e).
[224] *Corporations Act 2001* (Cth) s 942B(2)(f).
[225] *Corporations Act 2001* (Cth) s 942B(2)(g).
[226] *Corporations Act 2001* (Cth) s 942B(8).
[227] *Corporations Act 2001* (Cth) s 942B(2)(h).
[228] *Corporations Act 2001* (Cth) s 942B(2)(i).

- if the financial services licensee is a participant in a licensed market or a licensed clearing and settlement facility, a statement to that effect; [229] and
- any other statements or information required by the regulations.[230] Regulation 7.7.03 requires specified statements as to the purpose and content of the FSG and, if applicable, a Statement of Advice and Product Disclosure Document which may also be received by the client. Regulations 7.7.03A–7.7.04 require an FSG also to include statements as to the kind of compensation arrangements which the licensee has in place and as to any remuneration, commission and benefits which any other person will receive for referring clients to the licensee.

ASIC's Regulatory Guide 175 contains extensive guidance on ASIC's preferred approach to disclosure of information about remuneration, commissions and other benefits in an FSG.[231]

The level of detail of information about a matter which is required to be included in the FSG is that which a person would reasonably require for the purpose of making a decision whether to acquire financial services from the financial services licensee as a retail client. An FSG must be dated, with the date on which it was prepared or its preparation was completed.[232]

The content of an FSG provided by an authorised representative is specified in s 942C of the Corporations Act. An FSG provided by an authorised representative must contain the information required to be included in an FSG provided by a financial services licensee, and must also:

- include a statement setting out the name and contact details of the authorising licensee, or of each of the authorising licensees, and a statement that the representative is the authorised representative of that licensee or those licensees;[233]
- disclose remuneration (including commission) or other benefits that the authorised representative or its employer receives or is to receive in respect of providing those services; and any remuneration or other benefits that the authorising licensee or

[229] *Corporations Act 2001* (Cth) s 942B(2)(j).
[230] *Corporations Act 2001* (Cth) s 942B(2)(k).
[231] Australian Securities and Investments Commission, *Regulatory Guide 175 – Licensing: Financial product advisers – conduct and disclosure* (November 2017).
[232] *Corporations Act 2001* (Cth) s 942B.
[233] *Corporations Act 2001* (Cth) s 942C(2)(c).

licensees, any of its or their employees or directors, or any associates of those persons receives or is to receive in respect of the provision of those services;[234] and

- include information about any associations or relationships between the authorised representative or its employer and the issuers of any financial products, as well as information about any associations or relationships between the authorising licensee or licensees and its or their related body corporates and the issuers of any financial products, which might reasonably be expected to be capable of influencing the authorised representative in providing those services.[235]

A supplementary FSG may be used to correct a misleading or deceptive statement in the FSG; or correct an omission from the FSG of information it is required to contain; or update the information contained in the FSG. An authorised representative of a financial services licensee may not give a supplementary FSG to a person unless that licensee has authorised its distribution by the authorised representative.[236]

The providing entity can be liability to the client for defective disclosure in an FSG, under s 953B of the Corporations Act, but conduct in relation to an FSG or SFSG cannot be misleading or deceptive conduct for the purposes of s 12DA of the ASIC Act, s 1041H of the Corporations Act, or s 18 of the Australian Consumer Law.

General advice warning

Section 949A contains the requirement to provide a general advice warning to retail clients. Subject to exceptions, it is triggered when the general advice is provided to a retail client by a licensee or an authorised representative.

The providing entity must warn the client that the advice has been prepared without taking account of the client's objectives, financial situation or needs, and because of that, the client should, before acting on the advice, consider the appropriateness of the advice, having regard to the client's objectives, financial situation and needs. If the advice relates to the acquisition, or possible acquisition, of a particular financial product, the client is also warned that they should obtain a PDS relating to the product and consider it before making

[234] *Corporations Act 2001* (Cth) s 942C(2)(f).
[235] *Corporations Act 2001* (Cth) s 942C(2)(g).
[236] *Corporations Act 2001* (Cth) s 943A.

any decision about whether to acquire the product.[237] The warning must be given to the client at the same time as the advice is provided and by the same means as the advice is provided, and a licensee must take reasonable steps to ensure that its authorised representatives comply.

3.9 Disclosure requirements for personal advice to retail clients – SoA

Subject to exceptions,[238] if a licensee or authorised representative provides personal advice to a retail client, they must prepare and provide an SoA. This is the main document that records the advice, and the basis on which it was formulated, for a retail client. The usual process is that the client will receive an FSG at the first meeting with the licensee or authorised representative, then give instructions and at some time in the future receive the personal advice in or with the SoA.

If the SoA is not itself the means by which advice is provided to the client, then it must be given to the client when the advice is provided or as soon as practicable thereafter. In any event, it must be delivered before the providing entity provides the client with any further financial service which arises out of or is connected with that advice.[239] If the SoA is not given to the client when the advice is provided, the licensee or representative must inform the client of the information which would be required to be in an SoA relating to disclosure of remuneration (including commission) or other benefits that the providing entity and its associates will receive in connection with the advice, and of interests which may affect the recommendation.[240] There is an exception to the requirement as to the timing of giving the SoA if the client expressly instructs the providing entity that it requires a further financial service that arises out of, or is connected with, the advice to be provided immediately or by a specified time; and it is not reasonably practicable to give the SoA to the client before that further service is provided as instructed.[241]

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[237] Unless the product is a CGS depository interest, in which case the client is warned to obtain each information statement (see *Corporations Act 2001* (Cth) Part 7.9, Division 5C) for the class of CGS depository interests that includes the product.
[238] *Corporations Act 2001* (Cth) ss 946AA–946B.
[239] *Corporations Act 2001* (Cth) s 946C(1). For example, if advice involves a recommendation as to the purchase of a financial product, the provider of the advice would be required to give the SoA to the client before selling the client the product.
[240] *Corporations Act 2001* (Cth) s 946C(2).
[241] In that case, *Corporations Act 2001* (Cth) s 946C(3) requires that the providing entity give the SoA to the client within five business days after providing that further service, or sooner if practicable; or, if that further service is providing a financial product to a person and s 1019B (cooling-off period) will apply to that person's acquisition of the product, before the start of that cooling-off period, or sooner if practicable.

Section 947B sets out the required content of an SoA provided by a financial services licensee. That SoA must include statements and information as follows:

- a statement setting out the advice;[242]
- information about the basis on which the advice is or was given.[243] The explanation of the basis on which the advice is given should deal with the consideration given to the client's objectives, financial situation and needs and how the advice will meet those objectives, financial situation and needs, and should illustrate how the recommendation made to the client addresses the request for advice originally made by the client taking account of subsequent investigations and considerations on the part of the service provider;[244]
- a statement setting out the name and contact details of the providing entity;[245]
- information about any remuneration (including commission) or other benefits, that the providing entity, a related body corporate, a director or employee of the providing entity or a related body corporate or an associate[246] of any of them is to receive that might reasonably be expected to be or have been capable of influencing the providing entity in providing the advice;[247]
- information about any other interests, whether pecuniary or not and whether direct or indirect, of the providing entity or of any associate of the providing entity; and any associations or relationships between the providing entity or any associate of the providing entity and the issuers of any financial products, that might reasonably expect to be or have been capable of influencing the providing entity in providing the advice;[248]
- a statement setting out any warning required to be given to the client in relation to the advice under s 961H; and

[242] *Corporations Act 2001* (Cth) s 947B(2)(a).
[243] *Corporations Act 2001* (Cth) s 947B(2)(b).
[244] Explanatory Memorandum to the Financial Services Reform Bill, [12.52].
[245] *Corporations Act 2001* (Cth) s 947B(2)(c).
[246] A person will be an associate of a financial services provider for the purposes of s 947B(2)(d) in the circumstances set out in *Corporations Act 2001* (Cth) Pt 1.2 Div 2. An associate will include a person in partnership with whom the provider carries on a financial services business; a trustee of a trust of which the provider benefits or is capable of benefiting, other than in the course of money lending transactions carried out in the ordinary course of business (s 13(c)); and a person in concert with whom the provider is acting: *Corporations Act 2001* (Cth) s 15.
[247] *Corporations Act 2001* (Cth) s 947B(2)(d).
[248] *Corporations Act 2001* (Cth) s 947B(2)(e).

- any other information required by the regulations.[249] Regulation 7.7.11 provides that an SoA given by a financial services licensee must include information about all remuneration (including commission) and other benefits that a person has received or is to receive from referring another person to the licensee.

The purpose of disclosure of information as to commissions, fees, benefits or advantages at the stage of the SoA is to help the consumer identify any potential influences on or biases associated with the giving of advice and to identify any potential conflicts of interest that the adviser may have in recommending a specific product. Wherever possible, disclosure of any benefit or advantage should be in dollar amounts, otherwise percentage amounts or a written description must be provided, and benefits disclosed must include commission, soft dollar remuneration, sales quotas and volume bonuses. The requirement for disclosure of interests in the SoA reinforces the obligation of a financial services licensee to disclose its interest in a transaction, which arise at general law where a financial services licensee is in a fiduciary relationship with its client. The efficacy of this strategy in addressing conflicts of interest is discussed in Chapter 5.

The level of detail of the information that is required to be included in the SoA is that which a person would reasonably require for the purpose of deciding whether to act on the advice as a retail client.[250] The SoA must also include any information required by s 947D (see below) in circumstances that the advice recommended the replacement of one product with another and may also include other information.[251]

Where advice is given by an authorised representative, the SoA must include the information required to be included in an SoA given by a financial services licensee, and must also include a statement setting out:

- the name and contact details of the authorising licensee or licensees and a statement that the representative is the authorised representative of that licensee or licensees;[252]
- information about the remuneration (including commission) or other benefits that the representative, an employee of the representative, the authorising licensee or

[249] *Corporations Act 2001* (Cth) s 947B(2)(g).
[250] *Corporations Act 2001* (Cth) s 947B(3).
[251] *Corporations Act 2001* (Cth) s 947B(5).
[252] *Corporations Act 2001* (Cth) s 947C(2)(d).

licensees, an employee or director of the authorising licensee or licensees or any associate of those persons is to receive that might reasonably be expected to be or have been capable of influencing the representative in providing the licence;[253] and

- information about any other interests of the representative, its employees, the authorising licensee or licensees or their associates, and any associations or relationships between the representative, its employees, the authorising licensee or licensees or their associates and the issuers of any financial products, that might reasonably be expected to be or have been capable of influencing the authorised representative in providing the advice.[254]

Again, the level of detail of information required in an SoA given by a representative is that which a person would reasonably require for the purpose of making a decision whether to act on the advice provided as a retail client.[255]

Additional information must be included in the SoA where advice is, or includes, a recommendation that the client dispose of or reduce its interest in all or part of a particular financial product and instead acquire all or part of, or increase its interest in, another financial product, under s 947D(1) of the Corporations Act.

In that case, the SoA must include information as to any charges the client will or may incur in respect of that disposal, reduction, acquisition or increase, and any pecuniary or other benefits that the client will or may lose (temporarily or otherwise) as a result of taking the recommended action, to the extent that the information is known to or could reasonably be found out by the financial services licensee or representative.[256] That SoA must also include information as to any other significant consequences for the client of taking the recommended action that the licensee or representative knows, or ought reasonably to know, are likely, and any other information required by the regulations.[257] The clear intent is to limit the potential for 'churning'.[258]

[253] *Corporations Act 2001* (Cth) s 947C(2)(e).
[254] *Corporations Act 2001* (Cth) s 947C(2)(f).
[255] *Corporations Act 2001* (Cth) s 947C(3).
[256] *Corporations Act 2001* (Cth) s 947D(2)(a).
[257] *Corporations Act 2001* (Cth) s 947D(2)(b)–(c). If that licensee or representative knows or is reckless as to whether the client will or may incur such charges, lose such benefits or whether there will or may be such consequences, but does not know and cannot reasonably find out what those charges, losses or consequences are or will be, then the SoA must include a statement to the effect that there will or may be such charges, losses or consequences but the licensee or representative does not know what they are: *Corporations Act 2001* (Cth) s 947D(3).
[258] Explanatory Memorandum to the Financial Services Reform Bill, [12.58].

The providing entity can be liability to the client for defective disclosure in an SoA, under s 953B of the Corporations Act, but conduct in relation to an SoA cannot be misleading or deceptive conduct for the purposes of s 12DA of the ASIC Act, s 1041H of the Corporations Act, or s 18 of the Australian Consumer Law.

3.10 Pre-FoFA suitability rule for personal advice

Until 1 July 2012, a licensee or authorised representative who provided personal advice to a retail client was required to comply with the (now repealed) suitability requirement in s 945A(1) of the Corporations Act in relation to that advice. It was that:

> The providing entity must only provide the advice to the client if:
>
> (a) the providing entity:
>
> (i) determines the relevant personal circumstances in relation to giving the advice; and
>
> (ii) makes reasonable inquiries in relation to those personal circumstances; and
>
> (b) having regard to information obtained from the client in relation to those personal circumstances, the providing entity has given such consideration to, and conducted such investigation of, the subject matter of the advice as is reasonable in all of the circumstances; and
>
> (c) the advice is appropriate to the client, having regard to that consideration and investigation.

The providing entity could only provide advice if *all* three limbs in s 945A(1) were satisfied.[259] In *Commonwealth Financial Planning Ltd v Couper*, a case where a client lost the benefit of his exiting life insurance policy after being advised to acquire a replacement policy, the question of appropriateness was not argued before the Court of Appeal in New South Wales, but the Court did observe that, ‘for the advice to be appropriate, we incline to the view that it was necessary to do much more than say that the new policy was, like for

[259] *Australian Securities and Investments Commission v Cassimatis (No 8)* (2016) 338 ALR 209; [2016] FCA 1023 at [551].

like, dollar for dollar, better value. The comparison that needed to be made was, for the reasons given above, nowhere near so straightforward'.[260]

There was a limited defence in s 945A(2) in proceedings against an authorised representative for an offence based on subsection (1), if the licensee had provided the authorised representative with information or instructions about the requirements to be complied with in relation to the giving of personal advice; the representative's failure to comply with subsection (1) occurred because the representative was acting in reliance on that information or those instructions; and the representative's reliance on that information or those instructions was reasonable.

The former Part 7.7, Division 3, Subdivision B also contained a duty in s 945B to warn clients if the advice was based on incomplete instructions, similar to the current s 961H of the Corporations Act.

3.11 Post-FoFA requirements in Part 7.7A

The FoFA legislation[261] introduced a new Part 7.7A of the Corporations Act, commencing in July 2012. Compliance was voluntary for the first year of operation, and compulsory from 1 July 2013. Part 7.7A contains:

- performance obligations covering the provision of personal advice to retail clients, and
- restrictions on conflicted remuneration (other than for advice relating to life insurance).

Part 7.7A imposes obligations directly on 'providers' – defined as the individual or individuals who is or are to provide the advice to the client.[262] However that individual is not necessarily liable for a failure to comply – the responsibility for the compliance failure sits with the licensee unless the provider is an authorised representative.

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[260] *Commonwealth Financial Planning Ltd v Couper* [2013] NSWCA 444 at [108].
[261] *Corporations Amendment (Future of Financial Advice) Act 2012* (Cth) and *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth).
[262] *Corporations Act 2001* (Cth) s 961 provides that: (5) If it is not reasonably possible to identify the individual who is to, or individuals who are to, provide the advice, the person who is to provide the advice is the provider for the purposes of this Division. (6) A person who offers personal advice through a computer program is taken to be the person who is to provide the advice, and is the provider for the purposes of this Division.

The best interests and related duties

Part 7.7A contains duties directed at ensuring that the provider of personal advice to retail clients does so in (or at least having regard to) the client's best interests.

The policy intention behind the Part 7.7A, Division 2 was to incorporate an obligation to act in the best interests of the client into the law governing the provision of personal advice. The first recommendation made by the PJC in its report into financial products and services in 2009 was that the law should be amended 'to explicitly include a fiduciary duty for financial advisers operating under an [AFS licence], requiring them to place their clients' interests ahead of their own'.[263] Adopting that recommendation, in April 2010 the Government proposed a 'statutory fiduciary duty for financial advisers requiring them to act in the best interests of clients and to place the interests of their clients ahead of their own when providing personal advice to retail clients'.[264] In November 2011 the then responsible Minister moved away from characterising the duty as fiduciary, describing it as a 'statutory best interest duty … [requiring] financial advisers to act in the best interests of their clients, and to put their client's interests ahead of their own'. [265] It remains to be seen whether the new duties will achieve this policy objective, assuming the sector complies.[266]

[263] See Ripoll Report, above n 52, [6.29].

[264] In accepting the PJC's recommendation, the (then) Minister for Financial Services, Superannuation and Corporate Law indicated the Government's intention to introduce a 'statutory fiduciary duty for financial advisers requiring them to act in the best interests of their clients and to place the interests of their clients ahead of their own when providing personal advice to retail clients': see Office of the Hon Chris Bowen MP, Minister for Human Services, Minister for Financial Services, Superannuation and Corporate Law, "The Future of Financial Advice: Information Pack Monday 26 April 2010", 2. The final form of the legislation and related materials (including the Explanatory Memorandum to the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2010 and the Second Reading Speech by the Hon Bill Shorten MP on 24 November 2011) move away from describing the new statutory duty as a 'fiduciary duty' and instead describe it as a 'best interest' duty.

[265] House of Representatives *Hansard*, Thursday 24 November 2011, p 13751 (Shorten, Bill, MP).

[266] In January 2018, ASIC released the results of a review of a sample of customer advice files from large financial institutions that indicated that, 'In 10% of the sample advice files, we had significant concerns about the impact of the non-compliant advice on the customer's financial situation… We also found that in 75% of the customer files we reviewed (which includes the 10% identified above) the adviser had not demonstrated compliance with the best interests duty and related obligations'. Australian Securities and Investments Commission, *Report 562: Financial advice: Vertically integrated institutions and conflicts of interest* (January 2018) [20] – [21].

The duties which replace the former ss 945A (suitability) and 945B (warning for advice based on incomplete instructions) are spread across four operative provisions.[267]

The first is s 961B. Section 961B(1) says that the provider 'must act in the best interests of the client in relation to the advice'. However s 961B(2) goes on to say that the provider 'satisfies the duty in subsection (1), if the provider proves that the provider has done each of' the things set out in paragraphs (a) to (g).[268] These are that the provider has:

(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; and

[267] This proposed new duty, 'to act in the best interests of their clients, and to put their client's interests ahead of their own', took the Minister in his Second Reading Speech less than twenty words to express. In contrast, Pt 7.7A, Div 2 runs to 2,762 words. Even without the headings and the enforcement provisions, it is 1,736 words.
[268] Section 961B(2) does not actually include an obligation to act in the client's best interests. This contrasts with (for example) a corporate officer's statutory duty to act in 'exercise their powers and discharge their duties … in good faith in the best interests of the corporation' under *Corporations Act 2001* (Cth) s 181(1)(a).

(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.[269]

The steps to be taken to satisfy s 961B(2) (and therefore to have satisfied the best interests duty in s 961B(1)) are related to the advice process. Process may be an element of the equitable 'best interests' obligation but is not the whole of it.[270] The section is directed at the process or procedure by which a provider arrives at the advice, and not at the end to which the provider's efforts must be directed, which is the central concern of the equitable concept.[271] Section 961B(2) 'may be treated as providing a "safe harbour" for providers accused of breaching the best interests duty. If the provider can prove that he or she has done each of the seven things in s 961B(2), he or she will have satisfied the best interests duty'.[272] As with the equitable concept, the statutory best interests obligation is not a 'best outcomes' duty.

A person may be able to satisfy the best interests duty in s 961B(1) even though they do not fall within the 'safe harbour' of s 961B(2).

The second operative provision is s 961G, which says 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, had the provider satisfied the duty under section 961B to act in the best interests of the client'. It is worth contrasting this with the former s 945A(1)(c), which as Edelman J pointed out in the Storm Financial case, said that the adviser must not give the advice unless it is 'appropriate having regard to an investigation and consideration of the

[269] This is defined in *Corporations Act 2001* (Cth) s 961E, which provides that: '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'.
[270] The equitable best interest obligation 'seems to involve not just the pursuit of the best possible authorised end or outcome (as the trustee rationally conceives the matter) for the trust as a whole but also the observance of proper procedures and processes in decision-making': G W Thomas, "The Duty of Trustees to Act in the 'Best Interests' of their Beneficiaries" (2008) 2 *Journal of Equity* 177 at 202.
[271] On one view, the concept of acting in good faith in the interests of the principal indicates to the fiduciary "to what end he must bend his exertions", but it can be understood as a composite of the duties to act in good faith, with the requisite degree of care, and only for proper purposes': M Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-fiduciary Duties* (Hart Publishing, Oxford, 2010) 56. The 'bend his exertions' reference is to P Finn, *Fiduciary Obligations* (Law Book Company, Sydney, 1977) 27.
[272] *Australian Securities and Investments Commission v NSG Services Pty Ltd* [2017] FCA 345 at [17] (Moshinsky J).

subject matter of the advice as was reasonable in all of the circumstance'.[273] The new statutory requirement is that the adviser must not give the advice unless it would reasonable for that adviser, if it had in fact taken the steps outlined in s 961B(2), to conclude the advice is appropriate.

In *Australian Securities and Investments Commission v NSG Services Pty Ltd*, Moshinsky J observed, without reaching a concluded view, that:

> It was common ground [between ASIC and the defendant] that, while s 961B is concerned with the process or procedure involved in providing advice that is in the best interests of the client, s 961G is concerned with the content or substance of that advice. At first blush, the text of s 961B does not appear to support the proposition that s 961B is concerned with the *process* or *procedure* involved in providing advice that is in the best interests of the client. However, support for this way of viewing the focus of s 961B is provided by the context in which it appears, including the language of s 961G, the legislative history, and the legislative materials (see, in particular, the revised explanatory memorandum to the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (Cth) at [1.23], [1.24], [1.57]).[274]

The third operative provision is s 961H, which contains the obligation (similar to the old s 945B) to warn the client if the advice is based on incomplete or inaccurate information.

The fourth operative provision is in s 961J of the Corporations Act, which can be described as the 'priority' provision. It says that 'if the provider knows, or reasonably ought to know, that there is a conflict between the interests of the client and the interests' of the provider, an associate of the provider, an AFS licensee of whom the provider is a representative, an associate of a AFS licensee of whom the provider is a representative, an authorised representative who has authorised the provider under s 916B(3), or an associate of such an authorised representative, then 'the provider must give priority to the client's interests when giving the advice'.

The priority provision does not have an equivalent in equity, and its operation is unclear when the licensee is in a fiduciary relationship with the client. It may be that it has some work to do when the licensee and the client are not in a fiduciary relationship (which

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[273] *Australian Securities and Investments Commission v Cassimatis (No 8)* (2016) 338 ALR 209; [2016] FCA 1023 at [619].
[274] *Australian Securities and Investments Commission v NSG Services Pty Ltd* [2017] FCA 345 at [21] (Moshinsky J).

in this circumstance would require the licensee to refrain from acting unless it had the client's fully informed consent, and to act in the best interests of the client in any event).

Remuneration

The second policy goal of FoFA was to remove certain forms of conflicted remuneration, at least for advice arrangements entered into after the commencement of the new regime on 1 July 2013.[275] Existing commission arrangements as at that date are grandfathered,[276] and the ban on conflicted remuneration does not apply fully to risk products (including life insurance).

Conflicted remuneration is dealt with in Part 7.7A, Division 3 of the Corporations Act. It is defined in s 963A as:

> any benefit, whether monetary or non-monetary, given to a financial services licensee, or a representative of a financial services licensee, who provides financial product advice to persons as retail clients that, because of the nature of the benefit or the circumstances in which it is given:
>
> (a) could reasonably be expected to influence the choice of financial product recommended by the licensee or representative to retail clients; or
>
> (b) could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative.

Under s 963L of the Corporations Act, volume-based benefits are presumed to be conflicted remuneration for this purpose.

Specifically, the legislation prohibits:

- an AFS licensee and its representatives (including authorised representatives) from accepting conflicted remuneration (see s963E, 963G and 963H);
- product issuers and sellers from giving conflicted remuneration to a licensee and its representatives (see s963K); and
- an employer of a licensee or representative from giving its licensee or representative employees conflicted remuneration for work they carry out as an employee (see s963J).

[275] It was possible for AFS licensees to opt into the regime from 1 July 2012.
[276] The grandfathering arrangements are in *Corporations Act 2001 (*Cth) s 1528(1) and *Corporations Regulations 2001 (*Cth) reg 7.7A.16.

An AFS licensee will breach s 963E of the Corporations Act if one of its representatives, other than an authorised representative, accepts conflicted remuneration and the licensee is the responsible licensee. An AFS licensee must also take reasonable steps to ensure that its representatives do not accept conflicted remuneration, under s 963F of the Corporations Act.

For life insurance, the restriction on conflicted remuneration is different. There is no prohibition; while the *Corporations Amendment (Life Insurance Remuneration Arrangements) Act 2017* (Cth) amended the *Corporations Act 2001* to remove the exemption from the ban on conflicted remuneration for commissions paid in relation to certain life insurance products[277] it still enables ASIC to allow commissions to be paid if requirements are met relating to commission caps and clawback. ASIC, by instrument, has:

- set commission caps at 60% of the premium in the first year of the policy from 1 January 2020, with a maximum trailing commission of 20% of the premium in all subsequent years
- provided for a transition period, with the commission cap set at 80% from 1 January 2018 and 70% from 1 January 2019
- required clawback of 100% of the commission if the policy lapses (i.e. the policy is cancelled or not continued, or the policy cost is reduced) in the first year, and 60% clawback in the event of a lapse in the second year
- provided formulae for working out the commissions in different circumstances that have been contemplated, such as if there is a commission given because the policyholder has initiated an increase in the policy, resulting in a commission part way through the year, and
- provided formulae for working out clawback amounts depending on when the lapse occurs.[278]

FoFA also imposed limitations on certain other forms of remuneration, in Division 5 Subdivision A (volume-based shelf space fees[279]) and Subdivision B (asset-based fees on

[277] See also *Corporations Amendment (Life Insurance Remuneration Arrangements) Regulations 2017* (Cth).
[278] *ASIC Corporations (Life Insurance Commissions) Instrument 2017/510.*
[279] Product issuers are prohibited from paying volume-based shelf fees to platform operators. There is a presumption that a benefit is a volume-based shelf space fee if it is wholly or partly dependent on the total number or value of a fund manager's financial products available on a platform: *Corporations Act 2001* (Cth) s 964(2). The platform operator can rebut this presumption to the extent that it can be

borrowed amounts). The latter is prohibited so as not to encourage advisers to gear client portfolios and thereby increase their fees.

A further policy goal was to ensure more accountability in ongoing fee arrangements. An ongoing fee arrangement exists when a retail client is given personal advice and the client enters into an arrangement with the adviser, under which the client is charged an ongoing fee during a period of more than 12 months. Under s 962G of the Corporations Act, the adviser must give the client a fee disclosure statement on an annual basis, which discloses information about the previous 12 months of their ongoing fee arrangement.[280] It must also comply with the renewal notice and opt-in requirements under ss 962K - 962Q, unless granted an exemption by ASIC under s 962CA.[281]

The FoFA restrictions relating to fees and commissions are subject to grandfathering, which of itself creates complexities (including possible incentives for advisers to leave their clients in arrangements that still pay a commission).

3.12 Allocation of responsibilities

The regulatory framework for financial advice contemplates that there will usually be two or often three separate entities concerned in the provision of personal advice to a retail client. Depending on the business structure, they will be:

- the AFS licensee (usually a body corporate) and an individual who is an officer or employee of the licensee or a related body corporate, acting as its representative in the provision of the advice; or
- the AFS licensee (usually a body corporate) and an individual who is an authorised representative of the licensee acting as its representative in the provision of the advice; or
- the AFS licensee (usually a body corporate), a corporate authorised representative (CAR), and an individual who is an authorised representative of the licensee

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proved that all or part of the benefit is: (a) a reasonable fee for the services provided by the platform operator to the fund manager (see s 964(3)(a)); or (b) a discount or rebate paid to the platform operator by the fund manager where the value of the discount or rebate 'does not exceed an amount that may reasonably be attributed to efficiencies gained by the fund manager' because of the volume of business they have been able to generate by placing their product on the platform (s 964A(3)(b)).

[280] Australian Securities and Investments Commission, *Regulatory Guide 245 – Fee disclosure statements* (February 2017).

[281] Australian Securities and Investments Commission, *Regulatory Guide 183 – Approval of financial services sector codes of conduct* (March 2013).

nominated by the CAR who is acting as the licensee's representative in the provision of the advice.[282]

These structures envisage that a client receiving personal advice will do so from an individual who is named on the ASIC Register of Relevant Providers.[283] Although the legislation can accommodate the provision of robo-advice,[284] it was not widespread during the period under examination by the Royal Commission. For that reason, the legal framework for robo-advice (which is likely to be more relevant in the future) are not dealt with in this paper.

In the third of these structures, the CAR is likely to be a stand-alone small to medium business that is part of a 'dealer group'. Its relationship with the AFS licence will determine the extent to which it operate its business autonomously. Under Chapter 7 of the Corporations Act, the licensee has certain responsibilities relating to the provision of financial services by its representatives and is potentially liable to the client for the acts or omissions of its representatives. This should both require and incentivise the licensee to maintain a level of supervision of the activities of the CAR and is operatives.

The different structures raise different issues about the allocation of responsibility for compliance failures when they occur.

In the first structure, the statutory and general law obligations sit for the most part with the AFS licensee; its individual representatives have certain requirements imposed on them as 'providers' by Part 7.7A of the Corporations Act but the individual is not personally liable for breach of those requirements (unless the individual is an authorised representative).[285] The contractual arrangement (if one exists) is likely to be between the ASF licensee and the client. Because the advice provider (through its agent) is the AFS licensee, it will be the entity that owes any general law duties (including a duty of care and, if they arise, the proscriptive fiduciary duties).

In the second and third structures, involving the appointment of an (otherwise) independent small business and its nominees as authorised representatives of the licensee, a different pattern of responsibility emerges. The contract (if one exists) for the provision of advice is likely to be between the authorised representative and the client, rather than

[282] *Corporations Act 2001* (Cth) s 916B.
[283] *Corporations Act 2001* (Cth) s 966Q.
[284] *Corporations Act 2001* (Cth) s 961(6).
[285] *Corporations Act 2001* (Cth) ss 961K and 961Q.

between the licensee and the client. If a CAR is involved, the contract will typically be between the CAR and the client. The CAR is also, probably, the entity on which liability in tort or equity for advice failures would fall.[286]

In the first structure, the AFS licensee is responsible for discharging all the duties and responsibilities described in this Section, including those imposed by Parts 7.6 (AFS licensing), 7.7 (disclosure), 7.7A (best interests and remuneration), 7.8 (conduct of business) and 7.10 (conduct in relation to financial products) of the Corporations Act, Part 2, Division 2 of the ASIC Act (unconscionable conduct and consumer protection) and the general law. Conduct engaged in by its directors, employees and agents within the scope of their authority is taken to be conduct of the AFS licensee itself for the purposes of Chapter 7 of the Corporations Act and Part 2, Division 2 of the ASIC Act under the statutory attribution provisions.[287] This means that if a compliance failure or breach of duty occurs, the AFS licensee will be the accountable person.

When an authorised representative is involved, the pattern of responsibility is different. In this structure, the authorised representative, rather than the AFS licensee, is primarily responsible for discharging the functions and duties imposed by Parts 7.7 and 7.7A of the Corporations Act – that is, the FSG and SoA requirements and the best interest duties. The role of the AFS licensee is to discharge the duties and functions of a licensee, including the general obligations in s 912A of the Corporations Act. Of course, those general obligations include doing all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly; having in place adequate arrangements for the managing conflicts at the licensee and representative level; taking reasonable steps to ensure that its representatives comply with the financial services laws; having available adequate resources (including financial, technological and human resources) to carry out supervisory arrangements; and ensuring that its representatives are adequately trained, and are competent, to provide those financial services.[288]

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[286] Bearing in mind that the licensee will be jointly and severally liable to the client with the CAR, under *Corporations Act 2001* (Cth) Pt 7.6, Div 6 (see below).
[287] *Corporations Act 2001* (Cth) s 769B and *Australian Securities and Investments Commission Act 2001* (Cth) s 12GH.
[288] The design decision in FSR to regulate financial intermediaries at the firm, rather than individual level, relies on AFS licensees exercising their oversight responsibilities diligently and effectively. Where this does not occur, the system breaks down - see Australian Securities and Investments Commission, *Report 515 – Financial Advice: Review of how large institutions oversee their advisers*

It is clear that an authorised representative provides financial services 'on behalf of' the AFS licensee. In most situations the conduct of the authorised representative acting as agent will be treated as the conduct of the licensee under the statutory attribution provisions. However s 769B(7) of the Corporations Act provides that:

> Nothing in this section, or in any other law (including the common law) has the effect that, for the purposes of a provision of Part 7.7 or 7.7A, or a proceeding under this Chapter that relates to a provision of Part 7.7 or 7.7A, a financial service provided by person in their capacity as an authorised representative of a financial services licensee is taken, or taken also, to have been provided by that financial services licensee.

Part 7.7 imposes a number of statutory obligations directly on an authorised representative, because it is the 'providing entity' of FSGs and SoAs given to clients under that Part. Part 7.7A imposes obligations on the individual 'provider', who may be a licensee, an authorised representative or a representative. Although most of the obligations in Part 7.7A, Division 2 are imposed on the individual, the penalties resulting from any breach sit only with a licensee or authorised representative.[289] The licensee breaches a civil penalty provision if a representative, other than an authorised representative, breaches the obligation to act in the best interests of the client, the obligation to give appropriate advice, the obligation to warn the client or the obligation to give priority to the interests of the client.[290] Similar penalty arrangements to those that apply to licensees also apply to authorised representatives.[291]

Licensees also have a general obligation to take reasonable steps to ensure that their representatives (including authorised representatives) comply with their obligations.[292]

(March 2017). Failures uncovered by ASIC in preparing Report 515 have resulted in compensation payments of more than $50 million to clients: see Australian Securities and Investments Commission, 18-049MR, "Update on Advice Compliance Report: Additional $21.4 million compensation paid to customers" (20 February 2018).

[289] An individual who has been sub-authorised by a CAR is themselves an 'authorised representative' because of *Corporations Act 2001* (Cth) s 916B(6).

[290] *Corporations Act 2001* (Cth) s 961K.

[291] *Corporations Act 2001* (Cth) s 961Q. An authorised representative does not contravene the requirement in situations where the breach resulted from reasonable reliance by the authorised representative on information or material provided by the licensee. The onus is on the authorised representative to establish that the exception applies.

[292] *Corporations Act 2001* (Cth) s 961K.

Licensee is responsible to the client for the representative's conduct

In all three structures, Part 7.6, Division 6 makes an AFS licensee jointly and severally liable with the representative[293] to the client for any loss arising out of conduct of a representative (including an authorised representative) that relates to the provision of a financial service to a client, on which the client 'could reasonably be expected to rely … and on which the client in fact relied in good faith'.[294]

If the representative is the representative of only one AFS licensee, 'the licensee is responsible, as between the licensee and the client, for the conduct of the representative, whether or not the representative's conduct is within authority'.[295] If they are a representative of two or more licensees, then responsibility falls on whichever of the licensees has authorised the provision of the class of financial service.[296]

The responsibility of a licensee extends so as to make the licensee liable to the client in respect of any loss or damage suffered by the client as a result of the representative's conduct.[297] The effect of the Division is that, if a licensee is responsible for the conduct of their representative, the client has the same remedies against the licensee as they have against the representative.[298]

However, the legislation provides that 'nothing in this Division imposes … any criminal responsibility, or any civil liability under a provision of this Act apart from this Division' on a licensee that would not otherwise be imposed.

[293] The licensee and the representative (along with any other licensees who are also responsible) are all jointly and severally liable to the client in respect of those remedies: *Corporations Act 2001* (Cth) s 917F(2).
[294] *Corporations Act 2001* (Cth) s 917A(1).
[295] *Corporations Act 2001* (Cth) s 917B.
[296] *Corporations Act 2001* (Cth) s 917C. If there is more than one authorising licensee, the liability is joint and several. If the conduct is outside authority for all licensees, then all are jointly and severally liable unless the representative has disclosed the lack of authority to the client under s 917D.
[297] *Corporations Act 2001* (Cth) s 917E.
[298] *Corporations Act 2001* (Cth) s 917F(1).

3.13 Enforcement

As with the rest of Chapter 7, the advice provisions carry with them a complex array of statutory enforcement provisions. These have been the subject of significant academic study[299] and were recently examined as part of the ASIC Enforcement Review. The ASIC Enforcement Review was asked by the Minister in 2016 to inquire into 'the adequacy of civil and criminal penalties for serious contraventions relating to the financial system (including corporate fraud)'.[300] It reported to the Minister late in 2017 but its report has not yet been released publicly.

Criminal prosecutions

Defects in the advice process can lead to criminal liability.[301] Parts 7.6, 7.7, 7.7A and 7.8 between them create or found[302] 99 separate criminal offences for which a penalty is specified in Schedule 3 to the Corporations Act. The maximum penalties range from a fine of 10 penalty units[303] for individuals or 50 penalty units for corporations for some offences to 200 penalty units or 5 years imprisonment or both for individuals, or 1,000 penalty units[304] for corporations for others.

Part 7.10 deals with market misconduct and other misconduct relating to financial products or services, including knowingly making false or misleading representations or engaging in dishonest conduct. Leaving aside the insider trading offences, it founds seven criminal offences. The penalties are more severe than for other offences under Ch 7. In the case of an individual, the maximum criminal penalty for contraventions of the Pt 7.10 provisions is either or both of imprisonment for 10 years, and a fine the greater of 4,500

[299] Discussed in Pamela Hanrahan "Fairness and Financial Services: Revisiting the Enforcement Framework" (2017) 35 *Company and Securities Law Journal* 420. See for example, G Gilligan, A Godwin, J Hedges and I Ramsay, "Penalties Regimes to Counter Corporate and Financial Wrongdoing in Australia – Views of Governance Professionals" (2017) 11 *Law and Financial Markets Review* 4; H Bird, G Gilligan and I Ramsay, "The Who, Why and What of Enforceable Undertakings Accepted by the Australian Securities and Investments Commission" (2016) 34(7) *Company and Securities Law Journal* 491; G Gilligan, P Ali, A Godwin, J Hedges and I Ramsay, "An Analysis of Penalties Under ASIC Administered Legislation: Scoping the Issues" (ASIC Penalties Project Working Paper No 1, Centre for Corporate Law & Securities Regulation, The University of Melbourne, 31 May 2015); G Gilligan and H Bird, "Financial Services Misconduct and the Corporations Act 2001" (ASIC Penalties Project Working Paper No 2, Centre for Corporate Law & Securities Regulation, The University of Melbourne, 31 July 2015).

[300] Commonwealth of Australia, The Treasury, *ASIC Enforcement Review – Terms of Reference* (October 2016). The author was a member of the Expert Group assisting the Taskforce.

[301] See Baxt, Black and Hanrahan, above n 16, [2.81] – [2.84].

[302] Some of the offences founded in these Parts are created by *Corporations Act 2001* (Cth) s 1311; see *Re Whitebox Trading Pty Ltd* [2017] FCAFC 100.

[303] Currently set by the *Crimes Act 1914* (Cth) at $210 per unit.

[304] The maximum penalty for a body corporate convicted of a relevant offence is a fine five times the amount set out in Schedule 3: *Corporations Act 2001* (Cth), s 1312(1).

penalty units or three times any ascertainable benefit obtained. In the case of a corporation, the maximum penalty is a fine amounting to the greatest of 45,000 penalty units, three times the benefit obtained, or 10 percent of the corporation's annual turnover if that benefit cannot be ascertained.[305]

Division 2, Pt 2 of the ASIC Act deals with unconscionable conduct and consumer protection in the financial sector. It founds 22 offences[306] for which the maximum penalties are fines of 2,000 penalty units for individuals or 10,000 penalty units for bodies corporate.[307]

Criminal action requires the involvement of the Commonwealth Director of Public Prosecutions (CDPP) in any prosecution.[308] The relationship between ASIC and the CDPP is documented in a Memorandum of Understanding dated 1 March 2006.[309] The decision to prosecute is made by the CDPP in accordance with the Prosecution Policy of the Commonwealth;[310] it turns on whether there is sufficient evidence to prosecute the case, and whether it is evident from the facts of the case and all the surrounding circumstances that the prosecution would be in the public interest. Generally, 'the more serious the alleged offence is, the more likely it will be that the public interest will require that a prosecution be pursued'.[311] If an individual is convicted of an offence that is a contravention of the

[305] *Corporations Act 2001* (Cth), Sched 3, item 310. The precise formulations are: 'if the court can determine the total value of the benefits that have been obtained by one or more persons and are reasonably attributable to the commission of the offence—3 times that total value' and 'if the court cannot determine the total value of those benefits—10% of the body corporate's annual turnover during the 12-month period ending at the end of the month in which the body corporate committed, or began committing, the offence'.

[306] The offences are created by *Australian Securities and Investments Commission Act 2001* (Cth) s 12GB.

[307] *Australian Securities and Investments Commission Act 2001* (Cth) s 12GB. In 2017, both the Productivity Commission and Consumer Affairs Australia New Zealand (CAANZ) recommended that maximum penalties for corporations contravening of the corresponding provisions in the Australian Consumer Law should be increased to $10 million, three times the value of the benefit received from the breach, or 10 percent of annual turnover in the preceding 12 months if the benefit cannot be determined; and that the maximum penalty for individuals should be $500,000. See Commonwealth of Australia, Productivity Commission, *Consumer Law Enforcement and Administration – Research Report* (March 2017) Pt 4.3. The Government has since stated its intention to adopt these recommendations.

[308] There is a limited power for ASIC to issue penalty notices under s 1313 of the *Corporations Act* for certain low-level contraventions. This applies to 'prescribed offences', for which a penalty of five penalty units is prescribed in Schedule 3: see reg 9.4.01 of the *Corporations Regulations 2001* (Cth).

[309] *Memorandum of Understanding between the Australian Securities and Investments Commission and the Commonwealth Director of Public Prosecutions* (1 March 2006) available at https://download.asic.gov.au/media/3343247/asic-cdpp-mou-march-2006.pdf. For a useful discussion of the relationship, see Michelle Welsh, 'Civil Penalties and Responsive Regulation: The Gap between Theory and Practice' (2009) 33 *Melbourne University Law Review* 908, 916-20.

[310] The CDPP's Prosecution Policy is available at http://www.cdpp.gov.au/Publications/ProsecutionPolicy.

[311] Ibid, 3.

Corporations Act that is punishable by imprisonment for a period greater than 12 months, or of any other offence that involves dishonesty and is punishable by imprisonment for a period greater than 3 months, he or she is automatically disqualified from managing corporations for five years.[312]

Civil penalties

Several of the advice provisions are civil penalty provisions.[313] These are created by, respectively, Pt 9.4B of the Corporations Act and s 12GBA of the ASIC Act. There are 25 civil penalty provisions in Pts 7.6 – 7.8 and four (excluding the insider trading prohibitions) in Pt 7.10. Where a court has made a declaration of contravention of a civil penalty provision, it may order the payment of a civil penalty; the maximum civil penalty that can be imposed by a court following a declaration of contravention of one of these provisions is $200,000 for an individual or $1,000,000 for a corporation.[314] The court may also order the payment of compensation,[315] and disqualify the person concerned from managing corporations.[316]

By operation of s 12GBA of the ASIC Act, all the provisions of Pt 2, Div 2, Subdiv C, D and GC of the ASIC Act (other than section 12DA) are civil penalty provisions; this includes the two operative provisions of Subdiv C (unconscionable conduct), the 14 operative provisions of Subdiv D (consumer protection) and the two operative provisions of Subdiv GC (substantiation notices). The maximum civil penalty under Subdiv C and D is set at 2,000 penalty units for an individual or 10,000 for a corporation; under Subdiv GC it is set at the lower level of either 30 and 150 penalty units or 50 and 250 penalty units respectively depending on which of the operative provisions is contravened. As an alternative to bringing proceedings under s 12GBA, ASIC can issue an infringement notice.[317]

Criminal and civil penalty action is not available to ASIC for breach of a licensee's general obligations in s 912A of the Corporations Act.

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[312] *Corporations Act 2001* (Cth) s 206B.
[313] See Baxt, Black and Hanrahan, above n 16, [2.85] – [2.91].
[314] *Corporations Act 2001* (Cth) s 1317G(1B), (1F) and (1G). The exception is for contraventions of s 962P or 962S(1) which attract a lower maximum penalty of $50,000 for an individual or $250,000 for a corporation: *Corporations Act 2001* (Cth) s 1317G(1G).
[315] *Corporations Act 2001* (Cth) s 1317HA.
[316] *Corporations Act 2001* (Cth) s 206C.
[317] *Australian Securities and Investments Commission Act 2001* (Cth), Subdiv GB, Div 2, Pt 2.

ASIC's other enforcement options

ASIC also has other civil remedies available; these include injunctions,[318] compensation orders in respect of contraventions of Part 7.7A, Division 2[319] or Pt 7.10 of the Corporations Act[320] or Part 2, Division 2 of the ASIC Act;[321] unfair contract term declarations;[322] disqualification orders;[323] various consumer protection orders under the ASIC Act;[324] and 'any other orders that the Court thinks fit' in respect of a contravention of Chapter 7 or any other law relating to providing financial services.[325] ASIC can bring representative proceedings under s 50 of the ASIC Act[326] and can intervene in other proceedings arising under the Corporations Act or the ASIC Act.[327]

ASIC can take administrative action in circumstances where there is a risk of ongoing non-compliance with elements of the financial services law. These include issuing public warning notices,[328] varying, suspending or cancelling AFS licences,[329] or making banning orders.[330]

Finally, as an alternative to civil penalty, civil or administrative action ASIC may choose to enter into a formal negotiated settlement with a provider it believes has contravened the law. Under s 93AA of the ASIC Act, ASIC may accept an enforceable undertaking from a person on a matter relating to its regulatory activities as an alternative to

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[318] *Corporations Act 2001* (Cth) s 1324 and *Australian Securities and Investments Commission Act 200*1 (Cth) s 12GD. The remedies are available to be used in such a way that would serve some utility or purpose within the contemplation of the legislation, such as protecting the community from a real risk of wrongdoing where a person has a propensity to contravene the relevant Act or to mark the disapproval of the court and the community with the actions of the defendant. See *Australian Securities and Investments Commission v Mauer-Swisse Securities Ltd* (200) 42 ACSR 605; [2002] NSWSC 741 at [11].
[319] *Corporations Act 2001* (Cth) s 961M.
[320] *Corporations Act 2001* (Cth) s 1325(2).
[321] *Australian Securities and Investments Commission Act 2001* (Cth) s 12GM.
[322] *Australian Securities and Investments Commission Act 2001* (Cth) s 12GND.
[323] *Corporations Act 2001* (Cth) s 206E and *Australian Securities and Investments Commission Act 200*1 (Cth) s 12GLD (from managing corporations) and *Corporations Act 2001* (Cth) s 921A (from providing financial services).
[324] *Australian Securities and Investments Commission Act 200*1 (Cth) s 12GLA (non-punitive orders), 12GLB (adverse publicity orders), and 12GNB (orders to redress loss or damage suffered by non-party consumers).
[325] *Corporations Act 2001* (Cth) s 1101B.
[326] See A Johnson, "Public interest litigation under section 50 of the ASIC Act: The case for amendment" (2015) 33 *Company and Securities Law Journal* 528.
[327] *Corporations Act 2001* (Cth) s 1330 and *Australian Securities and Investments Commission Act 2001* (Cth) s 12GO. Australian Securities and Investments Commission, *Information Sheet 180: ASIC's approach to involvement in private court proceedings* (June 2013).
[328] *Australian Securities and Investments Commission Act 2001* (Cth) s12GLC.
[329] *Corporations Act 2001* (Cth) s 914A, 915B, and 915C.
[330] *Corporations Act 2001* (Cth) s 920A.

civil (but not criminal) proceedings. The significance of the undertaking lies in the consequence of breach. If ASIC considers that the person who gave the undertaking has breached any of its terms, ASIC may apply to the Court for a range of orders.[331] At the time of writing, Australia does not allow for deferred prosecution arrangements, although this has been proposed in relation to Commonwealth prosecutions. [332]

Client remedies

Similarly, a range of remedies may be available to a client who has received poor advice, but the cost of pursuing those remedies through the courts may be prohibitive for most households.

AFS licensees that advise retail clients are required to have in place appropriate alternative dispute resolution arrangements; therefore, clients may be entitled to recover under internal processes or (if their claim is under the relevant threshold) through the external dispute resolution scheme of which the licensee is a member.[333] Or they may be offered recompense through a remediation or compensation scheme being offered by the licensee.[334] These avenues for recovery have significant limitations also.

For those who choose to pursue a legal remedy, the usual pattern is to sue for breach of the adviser's duty of care, breach of fiduciary duty, and breach of the misleading or deceptive conduct provisions in the legislation (s 12DA of the ASIC Act, s 1041H of the Corporations Act and s 18 of the Australian Consumer Law applying as a law of the relevant state or territory). Because the licensee is jointly and severally liable with the adviser to the

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[331] These include an order that the person to comply with that term of the undertaking; an order directing the person to pay to the Commonwealth an amount up to the amount of any financial benefit that the person has obtained directly or indirectly and that is reasonably attributable to the breach; any order that the Court considers appropriate directing the person to compensate any other person who has suffered loss or damage as a result of the breach; and any other order that the Court considers appropriate: *Australian Securities and Investments Commission Act 2001* (Cth) s 93AA(4). ASIC's policy on the use of enforceable undertakings is set out in Australian Securities and Investments Commission, *Regulatory Guide 100 – Enforceable undertakings* (February 2015). ASIC has made extensive use of enforceable undertakings in the financial services area: see Helen Bird, George Gilligan, Andrew Godwin, Jasper Hedges and Ian Ramsay, "An Empirical Analysis of Enforceable Undertakings by ASIC between 1 July 1998 and 31 December 2015" (Working Paper No. 4, Centre for International Finance and Regulation and Melbourne Law School, 4 March 2016).

[332] See Commonwealth of Australia, Attorney-General's Department, *Proposed model for a deferred prosecution agreement schemes in Australia* (March 2017) available at https://www.ag.gov.au/Consultations/Pages/Proposed-model-for-a-deferred-prosecution-agreement-scheme-in-australia.aspx.

[333] See Ramsay Review, above n 214.

[334] See Australian Securities and Investments Commission, 18-049MR, "Update on Advice Compliance Report: Additional $21.4 million compensation paid to customers" (20 February 2018).

client for the conduct of its representatives under Part 7.6, Division 6 of the Corporations Act (discussed above), the client will usually proceed against the licensee if it is solvent.

Clients have available to them the following specific statutory remedies.

Client remedies		
Corporations Act s 953B	FSG or SoA was not provided or was defective	A person who suffers loss or damage as a result may recover against the licensee or authorised representative
Corporations Act s 1041H	Contravention of s 1041E, 1041F, 1041G or 1041H	A person who suffers loss or damage by conduct of another person that contravenes the provision may recover against the person or any person involved in the contravention
Corporations Act s 1317HA	Contravention of s 961L or 961Q (best interest duties)	A Court may order a licensee to compensate person who suffers damage. The person has standing under s 1317J(3A).
Corporations Act s 1325	Contravention of Part 7.10	A person who suffers loss or damage because of conduct engaged in in breach of the Part may seek orders, including the orders in s 1325(5), against the person or any person involved in the contravention
ASIC Act s 12GF	Contravention of the unconscionability or consumer protection provisions	A person who suffers loss or damage by conduct of another person that contravenes the provision may recover against the person or any person involved in the contravention

4. FINANCIAL PRODUCT SALES

Retail clients may acquire financial products in a 'recommendation situation'.[335] Or they may do so without advice, either directly or through an intermediary who arranges but does not advise (for example, through an execution-only broker). There are no restrictions on the kinds (or complexity) of financial products that may be offered to households in Australia.[336]

Regardless of the channel, a retail client will usually be entitled to receive pre-sale disclosure prepared by the issuer[337] about the financial product in the form of:

- a prospectus for securities,
- a shorter PDS for a superannuation product, margin loan or simple MIS product,
- a full PDS for other financial products, or
- an IDPS Guide for a platform or an MDA Guide for a managed discretionary account.

Mandatory pre-sale disclosure is the main legal mechanism used to protect or empower retail clients acquiring financial products in Australia. The rationale for mandatory disclosure is that providing clients with all relevant information will allow them to compare and choose products that meet their needs and are competitively priced. Whether disclosure is a useful regulatory strategy has been questioned.[338] Recent work in the field of behavioural economics supports the long-held intuition of many that mandatory disclosure is not particularly effective, at least outside its original securities law context where the purpose is to inform the market to ensure that all relevant information is captured in the price of securities in the secondary markets, rather than to support consumer choice.[339]

[335] *Corporations Act 2001* (Cth) s 1012A. This is where as part of personal advice to a retail client, a recommendation is made that the client acquire the product, either by way of issue or by way of purchase where the sale would attract the PDS requirement for a sale situation.
[336] Australian Securities and Investments Commission, *Report 384 – Regulating complex products* (January 2014).
[337] Or seller, in the limited situations in which a prospectus or PDS is required for secondary sales. These are explained below.
[338] In Ch 4, the Murray FSI observed that: 'Product disclosure plays an important part in establishing the contract between issuers and consumers. However, in itself, mandated disclosure is not sufficient to allow consumers to make informed financial decisions'. Murray FSI, above n 38.
[339] See the discussion in Murray FSI, above n 38, Ch 4; Baxt, Black and Hanrahan, above n 16, [15.5]; Financial Conduct Authority (UK) *Occasional Paper No 1: Applying behavioural economics at the*

The problem is exacerbated in product markets that operate as what the Dilbert cartoon character called 'confusopolies', describing the economic condition whereby the market force of competition is evaded by intentional obfuscation. This is the issue recently identified by the Productivity Commission – that the proliferation of financial products with trivial economic differences makes comparing features and prices almost impossible for consumers.[340] It might explain why clients routinely pay too much for financial products and services when simpler and cheaper alternatives would produce a better outcome. This is wasteful and, when it occurs in choice about superannuation and retirement income products that are subsidised through the tax system, damaging to the public interest.

Mandatory disclosure in the form of a prospectus or PDS is not required in all offer situations; for example it is not required for wholesale clients.[341] Wholesale clients may require and receive information about products from the issuer in the form of an information memorandum or other offer document; in this case the laws governing conduct in relation to financial products in Part 7.10 of the Corporations Act and Part 2, Division 2 of the ASIC Act apply. This includes the general prohibitions on misleading or deceptive conduct in s 1041H of the Corporations Act and s 12DA of the ASIC Act (which do not apply to disclosures in prospectuses and PDSs for the reasons explained above).

This Section explains the legal framework that governs the sale of financial products, including the mandatory disclosure requirements in Chapter 6D (for securities) and Part 7.9 (for other financial products) of the Corporations Act. It is important to note at the outset that ASIC does not 'pre-vet' or approve prospectuses or PDSs; it may examine some disclosure documents as part of its regulatory oversight but does not routinely review all documents. Prospectuses are lodged with but not registered by ASIC. Most PDSs are not required to be lodged with ASIC.

The mandatory disclosure requirements are supplemented by other legal rules that govern the sale of financial products, including advertising restrictions, restrictions on hawking, cooling-off arrangements, and regulation of arrangers and other non-advice

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Financial Conduct Authority (April 2013); Australian Securities and Investments Commission, *Report 427: Investing in hybrid securities – Explanations based on behavioural economics* (March 2015).
[340] See Productivity Commission, above n 131.
[341] There may be exceptions; *Corporations Regulations 2001* (Cth) reg 7.9.07CA extends the PDS requirements to wholesale clients in the case of discretionary mutual funds.

intermediaries, which are also outlined here.[342] Special responsible lending rules apply when the financial product being sold to the client is a margin lending facility.

4.1 Mandatory disclosure – securities

Securities are a subset of financial products. There are various definitions of 'securities' in the Corporations Act; for the purposes of the prospectus laws[343] it includes shares in a body, debentures of a body, legal or equitable rights or interests in shares or debentures, and options over unissued shares and debentures. Derivatives (including warrants) and interests in MIS are not included; offers of these products are instead regulated under Part 7.9 of the Corporations Act.

Requirement to provide disclosure to investors

Offers of securities for issue, and certain (limited) offers of securities for sale, require disclosure to investors in accordance with Pt 6D.2 of the Corporations Act if they are received in Australia, unless that requirement is expressly excluded by s 708, s 708AA or s 708A of the Corporations Act. Sales of securities require disclosure only where the sale is a direct or indirect off-market sale by a controller, or is a sale amounting to an indirect issue of securities.[344]

Section 708 of the Corporations Act contains exceptions of general application that are relevant in relation to the various types of primary offers (s 706) and secondary offers (s 707) referred to above. Section 708AA (enacted in 2007) and s 708A (enacted in 2004) are more specific in their operation. Section 708AA applies to offers made in connection with certain rights issues that would otherwise require disclosure under s 706. Section 708A applies to certain sale offers that would otherwise require disclosure under s 707(3) of the Corporations Act because the sale amounts to an indirect issue of the securities.

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[342] Most product issuers are subject to ongoing disclosure requirements on either a periodic or episodic basis while the products are held by clients. These are not discussed here.
[343] *Corporations Act 2001* (Cth) s 700.
[344] That is, where the seller controls the issuer and the sale is not made on a licensed market (either because the product is not quoted or because the offer is made off-market); where interests issued without disclosure to investors are offered for sale within 12 months of issue, and they were either issued or acquired for the purpose of the subscriber selling or transferring the product, or granting, issuing or transferring interests in, or options or warrants, over the product; and where financial products, sold by a controller off-market without disclosure to investors, are offered for resale within 12 months and the financial products were sold or acquired with the purpose of the acquirer "selling or transferring the product, or granting, issuing or transferring interests in, or options or warrants, over the product. *Corporations Act 2001* (Cth) s 707. This is an anti-avoidance mechanism. See Australian Securities and Investments Commission, *Regulatory Guide 173 — Disclosure for on-sale of securities and other financial products* (March 2016).

The general exceptions to the disclosure requirement in s 708 of the Corporations Act are for:

- small scale, private offers that do not exceed the 20 issues and $2 million in 12 month thresholds[345]
- offers to high net worth investors, sophisticated investors or professional investors[346]
- offers to certain people associated with the body[347]
- in some cases, existing securities holders[348]
- offers for no consideration and offers made as part of a takeover bid or a scheme of arrangement.[349]

Until 1999, all regulated securities offers required a prospectus. Now various forms of disclosure document can be used. These are described in the table in s 705 of the Corporations Act, reproduced here:

[345] *Corporations Act 2001* (Cth) s 708(1) – (7).
[346] Corporations Act 2001 (Cth) s 708(8) – (11). These categories overlap (but not perfectly) with the definition of wholesale client discussed in Chapter 2 above.
[347] *Corporations Act 2001* (Cth) s 708(12).
[348] *Corporations Act 2001* (Cth) s 708(13) – (14).
[349] *Corporations Act 2001* (Cth) s 708(16) – (18).

Disclosure document

	Type	*Sections*
1	***Prospectus*** The standard full disclosure document.	• content (710, 711, 713) • procedure (717) • liability (728 and 729) • defences (731, 733)
2	***Short-form prospectus*** • May be used for any offer. • Section 712 allows a prospectus to refer to material lodged with ASIC instead of setting it out. Investors are entitled to a copy of this material if they ask for it.	• content (712)
2A	***Two-part simple corporate bonds prospectus*** Must be used for any offer of simple corporate bonds.	• content (713C, 713D, 713E) • procedure (717) • liability (728 and 729 defences (731 and 733)
3	***Profile statement*** Section 721 allows a brief profile statement (rather than the prospectus) to be sent out with offers with ASIC approval. The prospectus must still be prepared and lodged with ASIC. Investors are entitled to a copy of the prospectus if they ask for it.	• content (714) • procedure (717) • liability (728 and 729) • defences (732 and 733)
4	***Offer information statement*** Section 709 allows an offer information statement to be used instead of a prospectus for an offer to issue securities if the amount raised from issues of securities is $10 million or less.	• content (715) • procedure (717) • liability (728 and 729) • defences (732 and 733)

Contents of the disclosure document

The disclosure requirements that apply in relation to each type of disclosure document are contained in Part 6D.4, Division 4 of the Corporations Act. In the case of a prospectus (other than a two-part simple corporate bonds prospectus), the requirements are contained in s 710, which contains the general disclosure test, and s 711, which prescribes specific information that must be included in the prospectus. The operation of s 710 is modified in relation to offers involving continuously quoted securities by s 713.

Section 710(1) of the Corporations Act requires that, subject to the limiting factors in s 710(1)(a) and (b), a prospectus must contain ‘all the information that investors and their professional advisers would reasonably require to make an informed assessment’ of the various matters set out in the table in s 710. For offers of securities, the matters are ‘the rights and liabilities attaching to the securities offered, the assets and liabilities, financial position and performance, profits and losses and prospects of the body that is to issue (or issued) the shares, debentures or interests’.[350]

The general disclosure obligation is subject to two limitations. The first is that the prospectus must contain the information ‘only to the extent to which it is reasonable for investors and their professional advisers to expect to find the information in the prospectus’. The second is that the prospectus must contain the information ‘only if a [named person] whose knowledge is relevant actually knows the information, or in the circumstances ought reasonably to have obtained the information by making enquiries’.

Section 713 of the Corporations Act allows for abridged disclosure for continuously quoted securities. The emphasis is on disclosing the effect that the offer or sale of securities will have on the issuer, and making public any material information about the issuer the disclosure of which has not been required under the continuous disclosure laws but which is required under the prospectus laws.

Section 711 of the Corporations Act contains specific disclosure obligations, relating to the terms and conditions of the offer, the nature and extent of the interests (if any) of certain people (associated with the offer) in the issuer and the offer, and the fees and benefits paid or provided to persons associated with the offer. If the prospectus states or implies that the securities will be quoted, certain statements must be included. The prospectus must be dated and set out the expiry date. Statements relating to its lodgement with ASIC must also be included.

[350] The table continues to refer to offers of interests in a managed investment scheme, but this is an anomaly as Part 6D.2 no longer applies to such offers.

For all disclosure documents, there is an overriding requirement in s 715A of the Corporations Act that the disclosure be 'clear, concise and effective'.[351] ASIC has issued specific guidance for prospectuses for debentures and notes, and for cash-box and investment companies.[352]

Lodgement of the disclosure document

Disclosure documents used for offers of securities must be lodged with ASIC under s 718 of the Corporations Act. There is no pre-vetting of documents, but ASIC conducts select compliance reviews of disclosure documents that are lodged with it.[353]

4.2 Mandatory disclosure – other financial products

Most financial products that are not securities can only be sold to retail clients if a PDS is provided in accordance with Part 7.9 of the Corporations Act.[354] The PDS regime differs from the prospectus laws in intent and design.[355] Different conduct triggers the obligation to disclose, different exemptions from the disclosure requirements exist, the form and content of the required disclosure is different, and the process in accordance with which offers must be made is different.[356]

Requirement to provide a PDS

Unless an exemption applies, a PDS must be provided where a financial product is issued or sold to a retail client. The requirement for a PDS to be given is contained in Part 7.9, Division 2 of the Corporations Act. There are three situations in which a PDS may be required in connection with the offer of financial products. These are:

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351 Australian Securities and Investments Commission, *Regulatory Guide 228 — Prospectuses: Effective disclosure for retail investors* (March 2016) [RG 228.22] – [RG 228.24].
352 Australian Securities and Investments Commission, *Regulatory Guide 69 — Debentures and notes: Improving disclosure for retail investors* (February 2012).
353 Australian Securities and Investments Commission, *Regulatory Guide 70 – Prospectuses for cash box and investment companies* (June 1999).
354 Usually it must be provided before the client offers to acquire the products, but sometimes it may be provided later: see e.g. *Corporations Act 2001* (Cth) ss 1012F and 1012G.
355 Until FSR, interests in registered MIS were covered by the prospectus regime, rather than the PDS regime. This remains the better option for listed MIS and would avoid the current difficulties for stapled securities (where the issuer must produce both a prospectus and a PDS). It would also streamline Part 7.9 which contains many provisions that are relevant only to listed products and that replicate aspects of the Chapter 6D disclosure regime.
356 *Woodcroft-Brown* v *Timbercorp Securities Ltd* [2011] VSC 427 at [123] – [126].

- a recommendation situation — that is, where as part of personal advice to a retail client, a recommendation is made that the client acquire the product, either by way of issue or by way of purchase where the sale would attract the PDS requirement for a sale situation
- an issue situation — that is, where the interest is offered or issued to the person as a retail client and they have not already received a PDS, and
- a sale situation — that is, where the interest is sold to a retail client but only where the sale is a direct or indirect off-market sale by a controller, or is a sale amounting to an indirect issue of interests.[357]

The obligation to provide a PDS only arises where the requisite jurisdictional nexus with Australia is present. Secondly, it only arises in relation to conduct engaged in by a 'regulated person' as defined in s 1011B of the Corporations Act.[358] Thirdly, it only arises in relation to interests issued in the course of a business of issuing financial products: s 1010B(1). Interests in managed investment products and superannuation products are always taken to be issued in the course of a business, because of s 1010B(2). Fourthly, the obligation only arises in relation to dealings with retail clients.

Fifthly, the obligation does not arise where s 1012D, 1012DAA, 1012DA or s 1012E or an ASIC instrument says that a PDS is not required. Several general exemptions from the PDS requirements are available under s 1012D of the Corporations Act and reg 7.9.07D–7.9.07FC of the Corporations Regulations. These include where the offer is made under a distribution reinvestment plan or switching facility, or where the issue will be for no consideration. A PDS is not generally required for an interest in an SMSF or an interim contract of insurance, for basic deposit products or travellers' cheques, or for carbon units,

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[357] That is, where the seller controls the issuer and the sale is not made on a licensed market (either because the product is not quoted or because the offer is made off-market); where interests issued without a PDS are offered for sale within 12 months of issue, and they were either issued or acquired for the purpose of the subscriber selling or transferring the product, or granting, issuing or transferring interests in, or options or warrants, over the product; and where financial products, sold by a controller off-market without a PDS, are offered for resale within 12 months and the financial products were sold or acquired with the purpose of the acquirer "selling or transferring the product, or granting, issuing or transferring interests in, or options or warrants, over the product.

[358] Regulated person is defined in s 1011B. It includes the issuer of the financial product, or the seller of the financial product (in a sale amounting to an off-market sale by a controller of the issuer, a sale amounting to an indirect issue of the financial product, or a sale amounting to an indirect off-market sale by the controller of the issuer). It also includes certain financial intermediaries who may be involved in the transaction, including any Australian financial services (AFS) licensee, any authorised representative of an AFS licensee, any person who is exempt from the requirement to be licensed by s 911A(2)(j) or exemptions granted by the regulations or by ASIC, and any person who is required to hold an AFS licence but who does not.

Australian carbon credit units or eligible international emissions units. Special arrangements exist for insurance held within superannuation products.[359]

Rights issues of continuously quoted interests can occur without a PDS in the circumstances set out in s 1012DAA, which corresponds in broad terms to s 708AA, mentioned above. Section 1012DA contains exemptions from the requirements to provide a PDS in connection with a secondary sale of interests, where one would otherwise be required under s 1012C, in certain circumstances. Section 1012E is the exemption for small scale, personal offers of interests in managed investment schemes that can be made without a PDS so long as they remain under the $2 million and 20 investors in 12-month threshold.[360] Offers and intended offers made without a PDS under s 1012E must not be advertised, because of s 1018A.

Contents of a PDS

Repeated attempts by government and regulators over the last 15 years to legislate for meaningful financial product disclosure have produced a patchwork of content requirements for PDSs, spread across many hundreds of pages in the Corporations Act, the Corporations Regulations and the Schedules to the Regulations,[361] ASIC instruments and ASIC Regulatory Guides. In broad terms, the pattern is as follows:

- Special 'shorter' PDS content requirements, introduced in 2010,[362] apply to margin loans,[363] superannuation products,[364] and 'simple' MIS.[365] The PDS

[359] These exemptions may depend on the issuer providing some minimal alternative disclosure instead.
[360] Four conditions must exist for the exemption to operate. They are that all of the financial products are issued by the same person; each offer is a personal offer as defined in s 1012E(5); none of the offers results in a breach of the 20 purchasers ceiling; and none of the offers results in a breach of the $2 million ceiling for that year. The person seeking to rely on the exemption has the onus of establishing that these conditions exist: *Chugg* v *Pacific Dunlop Ltd* [1990] HCA 41 at 257–9; *Australian Securities and Investments Commission* v *Cyclone Magnetic Engines Inc* (2009) 27 ACLC 312 at [37] and [39]–[40]; *Australian Securities and Investments Commission* v *Great Northern Developments Pty Ltd* (2010) 79 ACSR 246; [2010] NSWSC 1087 at [44]
[361] This includes *Corporations Regulations 2001* (Cth) Part 7.9 and Schedules 10 (disclosure of fees and other costs) and 10A (modifications of Part 7.9 of the Act) 10BA (modifications of the Act relating to short-form PDSs), 10C (form and content of product disclosure statement – margin loan), 10D (form and content of PDS – superannuation product to which Subdiv 4.2B of Division 4 of Part 7.9 of the Regulations applies), and 10E (form and content of PDS – simple MIS).
[362] *Corporations Amendment Regulations 2010 (No 5)* (Cth). The 'shorter' PDS regime is not to be confused with the 'Short-Form PDS' provided for, since 2005, in Schedule 10BA.
[363] *Corporations Regulations 2001* (Cth) Pt 7.9, Div 4, Subdiv 4.2A and Schedule10A, Pt 5A and Schedule 10C.

for these products must not exceed a prescribed page length (although they can incorporate additional material by reference[366]) and must provide specified information under prescribed headings.

- Special content requirements apply to offers of 'continuously quoted securities', under s 1013FA.
- Otherwise, a PDS must comply with the general PDS content requirements, contained in s 1013C, 1013D and 1013E as modified by the Regulations (requiring more, less or different disclosure) either generally or for particular products including warrants,[367] market-traded derivatives,[368] financial claims schemes,[369] financial products issued by unauthorised foreign insurers,[370] general insurance products,[371] and consumer credit insurance.[372]

Section 1013C prescribes the contents of a PDS. It must contain the information required under s 1013D (specific disclosures) and 1013E (general disclosure requirement), and any of s 1013H–1013K that apply.[373] The disclosure obligations are limited by ss 1013C(2) and 1013F. The information included must be 'worded and presented in a clear, concise and effective manner'.[374]

Section 1013D contains a long list of specific disclosure requirements; the PDS must include 'such of the [prescribed] information as a person would reasonably require for the purposes of making a decision, as a retail client, whether to acquire the financial product'. The list includes:

- the name and contact details of the issuer;

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364 *Corporations Regulations 2001* (Cth) Pt 7.9, Div 4, Subdiv 4.2B and Schedule 10A, Pt 5B and Schedule 10D.
365 *Corporations Regulations 2001* (Cth) Pt 7.9, Div 4, Subdiv 4.2C and Schedule 10A, Pt 5C and Schedule 10E. Simple MIS is defined in *Corporations Regulations 2001* (Cth) reg 1.0.02; the intention is to include only those MIS that invest predominantly in assets that are easily realisable (for example assets that can be sold for market value within 10 days).
366 The shorter PDS regime allows for "a matter contained in writing" to be "applied, adopted or incorporated" in a PDS. This is permitted under the modified s 1013C contained in sub-item 5C.1 of Pt 5C in Schedule 10A to the *Corporations Regulations 2001* (Cth), so long as it is done in the manner set out in reg 7.9.11X. Regulation 7.9.11X sets out detailed requirements applying to information incorporated by reference.
367 *Corporations Regulations 2001* (Cth) Pt 7.9 Div 2A.
368 *Corporations Regulations 2001* (Cth) Pt 7.9 Div 2B.
369 *Corporations Regulations 2001* (Cth) reg 7.9.14D.
370 *Corporations Regulations 2001* (Cth) reg 7.9.15.
371 *Corporations Regulations 2001* (Cth) reg 7.9.15D, 7.9.15E, 7.9.15F.
372 *Corporations Regulations 2001* (Cth) reg 7.9.16.
373 These relate to PDSs for interests that are to be listed (s 1013H) and for interests that are ED securities (s 1013I). If the PDS is lodged with ASIC (which is required under s 1015B for listed interests), this must be stated in the PDS (s 1013J). *Corporations Act 2001* (Cth) s 1013K deals with consents from experts quoted in the PDS. The PDS may incorporate material by reference on certain conditions: *Corporations Regulations 2001* (Cth) reg 7.9.15DA.
374 *Corporations Act 2001* (Cth) s 1013(3).

- significant benefits and risks associated with holding the product. Whether a particular circumstance is a significant risk 'is to be considered having regard, inter alia, to the probability of occurrence of the risk, the degree of impact upon investors, the nature of the particular product and the profile of the investors';[375]
- costs, fees and payments, and commissions impacting on returns;[376]
- other significant product characteristics or features;
- taxation features;
- dispute resolution arrangements, cooling off, and access to supplementary information; and
- for products with an investment component, the consideration given to labour standards and environmental, social or ethical considerations in making investment decisions.[377]

In addition to the specific disclosure required under s 1013D, and subject to ss 1013C(2) and 1013F, s 1013E of the Corporations Act, the legislation requires that a PDS contain 'any other information that might reasonably be expected to have a material influence on the decision of a reasonable person, as a retail client, whether to acquire the product'. Sections 1013D and 1013E are complementary 'in that s 1013E is designed to enhance the disclosure obligation'.[378]

For this purpose the retail client is 'taken to be reasonably intelligent, to exercise common sense, to be reasonably diligent and reflective when deciding whether to make an investment, and to have a reasonable tolerance for risk'.[379]

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[375] *Australian Securities and Investments Commission* v *Avestra Asset Management Limited (in liq)* (2017) 120 ACSR 247; [2017] FCA 497 (Beach J). The risks to be disclosed must be 'real in the sense that there is a probability of occurrence and a consequence that is measurably significant': *Woodcroft-Brown* v *Timbercorp Securities Ltd* (2011) 85 ACSR 551; [2011] VSC 427 at [101]; upheld *Woodcroft-Brown* v *Timbercorp Securities Ltd* (2013) 96 ACSR 307; [2013] VSCA 284 at [130] – [132].

[376] Under *Corporations Act (2001)* (Cth) s 1013D(1)(m) as modified by *Corporations Regulations 2001* (Cth) reg 7.9.15A, amounts included in the PDS because of s 1013D(1)(b) (benefits), (d) (costs) and (e) (commissions), must be stated in dollars, unless ASIC has determined otherwise. ASIC's detailed policy on dollar disclosure is set out in Australian Securities and Investments Commission, *Regulatory Guide 182: Dollar disclosure* (December 2017). Where the PDS relates to certain MIS and superannuation products not covered by the shorter PDS regime, enhanced fee disclosure rules apply under *Corporations Regulations 2001* (Cth) Pt 7.9, Div 4C and Schedule 10, Pt 2.

[377] See *Corporations Act 2001* (Cth) s 1013DA; *Corporations Regulations 2001* (Cth) reg 7.9.14C; Australian Securities and Investments Commission, *Regulatory Guide 65: Section 1013DA disclosure guidelines* (November 2011).

[378] *Woodcroft-Brown* v *Timbercorp Securities Ltd* (2011) 85 ACSR 551; [2011] VSC 427 at [119].

[379] *Australian Securities and Investments Commission v Avestra Asset Management Limited* (in liq) (2017) 120 ACSR 247; [2017] FCA 497 at [200].

The disclosure obligations contained in s 1013D and 1013E are subject to the overriding limitations in s 1013C(2) and 1013F of the Corporations Act. These are:

- Disclosure is only required of matters within the actual knowledge of the person preparing the PDS and certain others involved in its preparation. The effect of s 1013C(2) is 'to qualify the disclosure required under ss 1013D and 1013E by not requiring disclosure under those sections to the extent the information concerned is not known by the disclosing party'.[380]
- Disclosure is not required of information if it would not be reasonable for a person considering, as a retail client, whether to acquire the product to expect to find the information in the PDS. It is for the person alleging defective disclosure to 'show that the matters upon which he sought to rely fell outside s 1013F(1)'.[381]

ASIC has issued detailed policy guidance on the full PDS requirements, in ASIC Regulatory Guide 168.[382] It has also issued specific 'if not, why not' disclosure policies that it encourages issuers to adopt[383] in PDSs for complex and alternate investments. These use a guided disclosure approach, based on whether investment products meet certain benchmarks (that is, legal or business characteristics) and if not, why not, and what the effect is for investors. These policies cover hedge funds, mortgage funds, unlisted property trusts, infrastructure schemes, agribusiness investments and contracts for difference and other OTC derivatives.[384]

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[380] *Woodcroft-Brown v Timbercorp Securities Ltd* (2013) 96 ACSR 307; [2013] VSCA 284 at [31].

[381] *Woodcroft-Brown* v *Timbercorp Securities Ltd* (2013) 96 ACSR 307; [2013] VSCA 284 at [33]. Relevant factors to be taken into account in determining this include the nature of the product (including its risk profile), the extent to which the product is well understood by the market, the kinds of things people can reasonably be expected to know, the effect of continuous disclosure in relation to ED securities, and the way in which the product is promoted, sold or distributed. There is a further regulation-making power to specify additional factors, under s 1013F(2)(f).

[382] Australian Securities and Investments Commission, *Regulatory* Guide 168 - *Disclosure: Product Disclosure Statements (and other disclosure obligations)* (October 2011).

[383] ASIC does not have a rule-making power to require disclosure in a particular form. These Regulatory Guides explain the basis on which ASIC will interpret and apply the general disclosure obligation for offers of these product lines.

[384] Australian Securities and Investments Commission, *Regulatory Guide 45 - Mortgage schemes: Improving disclosure for retail investors* (March 2012); Australian Securities and Investments Commission, *Regulatory Guide 46 - Unlisted property schemes: Improving disclosure for retail investors* (March 2012); Australian Securities and Investments Commission, *Over-the-counter contracts for difference: Improving disclosure for retail investors* (August 2011); Australian Securities and Investments Commission, *Regulatory Guide 231 - Infrastructure entities: Improving disclosure for retail investors* (January 2014); and Australian Securities and Investments Commission, *Regulatory Guide 232 - Agribusiness managed investment schemes: Improving disclosure for retail investors* (January 2014); Australian Securities and Investments Commission, *Regulatory Guide 240 - Hedge funds: Improving disclosure* (October 2013).

PDS lodgement and in-use notices

Generally, a PDS is not required to be lodged with ASIC. The exception is for PDSs relating to listed products; under s 1015B of the Corporations Act, the PDS must be lodged with ASIC if the interests to which the PDS relates can be traded on a financial market, or if the PDS includes a statement (made in accordance with s 1013H) that the interests will be able to be traded on a financial market.

If s 1015B does not apply, then s 1015D of the Corporations Act[385] requires the responsible person to notify ASIC when a PDS comes into, or out of, use and where certain changes are made to fees.

4.3 Mandatory disclosure – IDPS and MDA

Modified disclosure requirements apply for platforms and managed discretionary accounts, both of which ASIC treats as financial products for the purposes of Chapter 7 of the Corporations Act.

Disclosure for platforms

Special pre-sale disclosure obligations exist for platform operators. If the platform is an IPDS that is not a registered MIS, then the operator of the platform must provide the client with an IDPS Guide prepared in accordance with ASIC Regulatory Guide 148.[386] The IDPS Guide may be or include the FSG; the contents are prescribed in Section D of the Regulatory Guide. However if the platform is an IDPS-like registered MIS, the ordinary disclosure obligations in Part 7.9 of the Corporations Act apply.[387]

[385] As modified by *Corporations Regulations 2001* (Cth) reg 7.9.16T.
[386] Australian Securities and Investments Commission, *Regulatory Guide 148 - Platforms that are managed investment schemes and nominee and custody services* (December 2016).
[387] Ibid, [RG 148.173].

Disclosure for managed accounts

ASIC Regulatory Guide 179 deals with managed discretionary accounts ('MDA'). An MDA is a facility through which a client's portfolio is managed on an individual basis by another person (called the MDA provider) at the MDA provider's discretion, subject to any agreed limitation. This type of arrangement may be described as a separately managed account, individually managed account, investment advisory program or a managed discretionary portfolio service. ASIC treats an MDA as a financial product, but gives the MDA provider an exemption from the PDS requirement if it includes additional prescribed disclosure in the FSG. That disclosure is detailed in Section D of ASIC Regulatory Guide 179.

4.4 Other financial product sales laws

Regulation of arrangers

An intermediary who arranges, without advice, the acquisition by a client of a financial product may require an AFS licence (or an authorisation to do so on behalf of a licensee). This is because the definition of financial service, discussed in Section 2 above, includes 'dealing in a financial product'. Dealing is in turn defined to include 'arranging for a person to engage in conduct referred to in subsection (1)'- that is, applying for or acquiring a financial product, issuing a financial product, underwriting securities or MIS interests, varying a financial product, or disclosing of a financial product – unless the actions concerned amount to providing financial product advice'.

ASIC considers that 'arranging occurs when a person brings into effect the issue, variation, disposal or acquisition of, or application for, a financial product'.[388]

If a person carries on a business of dealing in financial products, including arranging, the person must be appropriately licensed or authorised. The licensing regime is explained in Chapter 3 above.

[388] Australian Securities and Investments Commission, *Regulatory Guide 36 – Licensing: Financial product advice and dealing* (June 2016), Section D.

Cooling off

Part 7.9, Division 5 of the Corporations Act allows for 'cooling off' in connection with the issue, or sale pursuant to a PDS, to a retail client of certain financial products. The cooling-off right allows the client, within 14 days of the earlier of receiving the confirmation required under s 1017D or the end of the fifth day after the issue or sale, to return the product and obtain a refund. The availability of the right is limited by Corporations Regulations reg 7.9.64; for example, cooling-off is not available in relation to interests in registered managed investment schemes that are or are to be listed, or that are not liquid for the purposes of s 601KA of the Corporations Act. It is also not available in relation to financial products offered or issued under a distribution reinvestment plan or switching facility, or following an additional contribution made under an existing agreement or contract. Financial products issued as consideration for an offer made under a takeover bid under Chapter 6 are also excluded.

Where the right to return the product is available, the provisions of s 1019B and Corporations Regulations regs 7.9.64A–7.9.70 apply. In particular, these sections impose procedural requirements for the exercise of the cooling-off right and allow for the adjustment of the amount to be returned to the client to allocate market risk and take account of taxes and charges.

Advertising

The Corporations Act restricts advertising of financial products. Small scale private offers cannot be advertised.[389] Other offers may be advertised so long as certain prescribed information is provided. Generally, this requires that the advertisement draw attention to the PDS or prospectus for the product.[390] ASIC Regulatory Guide 234 provides extensive guidance.[391]

Hawking

Hawking of interests in registered managed investment schemes is prohibited by s 992AA of the Corporations Act. Securities hawking is similarly restricted by s 736 of the Corporations Act.

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[389] *Corporations Act 2001* (Cth) ss 734 and 1018B.
[390] *Corporations Act 2001* (Cth) ss 73s 1018A and 1018B.
[391] Australian Securities and Investments Commission, *Regulatory Guide 234 - Advertising financial products and advice services including credit: Good practice guidance* (November 2012).

4.5 Margin lending

Margin lending is a special case. Unlike other forms of credit, offering a margin lending facility to a client amounts to the offer of a financial product. A PDS meeting the requirements in Schedule 10C of the Corporations Regulations must be provided to a retail client. Beyond that, the margin loan provider must meet tailored responsible lending requirements contain in Part 7.8, Division 4A of the Corporations Act. These include making inquiries and verifications, and making an assessment that the loan (or increase in the loan) is not unsuitable for the client, determined in accordance with s 985H of the Corporations Act.

4.6 Enforcement

Criminal prosecutions and ASIC enforcement

The pattern of enforcement in Chapter 6D and Parts 7.8 and 7.9 of the Corporations Act is similar to that for the remainder of Chapter 7, described in Chapter 3 above. Chapter 6D creates 17 criminal offences, with maximum penalties ranging from a fine of 25 penalty units[392] for individuals or 125 penalty units for corporations for some offences to 200 penalty units or 5 years imprisonment or both for individuals, or 1,000 penalty units[393] for corporations for others.

The margin lending laws create five criminal offences with penalties of 50 or 100 penalty units for individuals and 250 or 500 penalty units for corporations, and nine civil penalty provisions. The PDS requirements in Part 7.9 give rise to 87 criminal offences with penalties of between 50 penalty units and 200 penalty units and 5 years imprisonment for individuals, and 250 and 1,000 penalty units for corporations.

Stop orders

Section 739 of the Corporations Act gives ASIC the power to issue 'stop orders' in relation to offers of securities that need disclosure to investors under Pt 6D.2. The stop order may be triggered by a defect in a disclosure document or in an advertisement relating to a regulated offer. Ordinarily, a stop order can be issued only after ASIC has held a hearing giving interested persons an opportunity to be heard, but ASIC can issue interim stop orders without a hearing in certain circumstances.

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[392] Currently set by the *Crimes Act 1914* (Cth) at $210 per unit.

[393] The maximum penalty for a body corporate convicted of a relevant offence is a fine five times the amount set out in Schedule 3: *Corporations Act 2001* (Cth), s 1312(1).

ASIC has a similar power under s 1012E(2) to issue stop orders, in circumstances where a ‘disclosure document or statement’ is defective within the meaning of s 1020E(11) or is not worded and presented in a clear, concise or effective manner. Again, a stop order can be issued only after ASIC has held a hearing giving interested persons an opportunity to be heard, but ASIC can issue interim stop orders without a hearing in certain circumstances.

Client remedies

A person who suffers loss or damage because a disclosure document for securities contravenes s 728(1) of the Corporations Act may be entitled to recover under s 729, subject to various defences.

Section 1022B is an omnibus provision that allows for recovery in a variety of situations related to the issue, sale and purchase of financial products (other than securities and government bonds) issued in the course of a business of issuing financial products. Section 1022B(1)(a), (aa), (ab), (ac), (b) and (e) refers to situations where a person is required by the Act to provide a document or information and does not do so. Section 1022B also applies where a person gives another person a defective PDS or supplementary PDS.

The misleading or deceptive conduct provisions in the legislation (s 12DA of the ASIC Act, s 1041H of the Corporations Act and s 18 of the Australian Consumer Law applying as a law of the relevant state or territory) do not apply to conduct in relation to disclosure documents and PDSs.

5. MANAGING CONFLICTS

The structure of the financial services sector in Australia means that the interests of AFS licensees and their representatives are not always aligned with those of their clients when they are advising on or arranging financial product transactions.[394] The legislation responds by imposing a statutory obligation on an AFS licensee to:

> … have in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services as part of the financial services business of the licensee or the representative.[395]

Because it applies to all AFS licensees, s 912A(1)(aa) applies in the context of both fiduciary and non-fiduciary relationships. Justice Black has pointed out that the financial services law in Australia is such that 'there can be situations where only a statutory duty applies, for example, where a relationship between an adviser and a client is not fiduciary, or a fiduciary duty is excluded, or the relevant conduct is not within the scope of any fiduciary duty. There can also be cases where both the fiduciary and statutory duties apply'.[396] The latter is common in the Australian financial sector; this is recognised by ASIC's observation that 'many [AFS] licensees have fiduciary obligations to their clients to whom they provide advice or for whom they act in a trustee capacity. These obligations operate in addition to the statutory requirements and should be taken into account when formulating conflicts management arrangements'.[397]

The fact that s 912A(1)(aa) applies in both contexts is important, because it requires something different of AFS licensees in each context. The operation of s 912A(1)(aa) is not settled, but it is suggested that:

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394 See, for example, Australian Securities and Investments Commission, *Report 562: Financial advice: Vertically integrated institutions and conflicts of interest* (January 2018). See also Australian Securities and Investments Commission, *Regulatory Guide 148 - Platforms that are managed investment schemes and nominee and custody services* (December 2016) [RG 148-183] – [RG 148.187] (management of conflicts by platform operators), and Australian Securities and Investments Commission, *Regulatory Guide 179 – Managed discretionary account services* (September 2016) [RG 179.67] – [RG 179.87] (management of conflicts by MDA providers).

395 *Corporations Act 2001* (Cth) s 912A(1)(aa), discussed in Section 3.3 above.

396 The Hon Justice Ashley Black, 'Equitable and statutory regulation of conflicts of interests and duty'. Presentation at University of New South Wales Law School, 10 May 2016.

397 Australian Securities and Investments Commission, *Regulatory Guide 181 – Licensing: Managing conflicts of interest* (August 2004), [RG181.19].

- To the extent or in the areas that the relationship is not fiduciary, the statutory obligation to manage conflicts requires the AFS licensee to ensure the existence of the conflict is fully and candidly disclosed to the client. Once the conflict is disclosed, the licensee or representative can pursue its own interests, within the bounds of commercial standards of honesty, careful conduct and promise keeping[398] (including those in Part 2, Division 2 of the ASIC Act).
- Where the relationship is fiduciary, the statutory obligation to manage conflicts accommodates but does not displace the fiduciary proscriptions. This means that the AFS licensee cannot act (or allow the representative to act) in circumstances where there is a real and sensible possibility that the licensee's or representative's personal interest, or duty to another person, may conflict with its duty to act in the best interests of the client, unless that would be permitted under fiduciary principles (for example because effective Chinese wall arrangements are in place or where the client has given its fully informed consent).

The discussion that follows assumes that a financial adviser providing personal advice to a client (whether retail or wholesale) will owe fiduciary duties to the client in connection with that advice. In contrast, an AFS licensee or its representative who is a 'mere salesman' of financial products will not. The dividing line between the two is not always clear; the (non-excludable) obligations imposed on licensees, authorised representatives and individual advice providers by former s 945A and current Part 7.7A, Division 2 of the Corporations Act are a relevant consideration. The circumstances in which fiduciary relationships arise in connection with financial intermediation are discussed in Section 3.3 above.

The statutory conflicts management obligation

Section 912A(1)(aa) was introduced into the Corporations Act three years after the enactment of FSR, by the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth). The view at the time was that the 'efficiently, honestly and fairly' standard introduced by FSR included a requirement to manage conflicts,[399] but that industry developments meant it should be made more explicit:

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398 See Lord Millett's Foreword to J McGhee, *Snell's Equity* (Sweet & Maxwell, London, 30th ed 2000), distinguishing between the core concerns of equity and the common law.
399 *Australian Securities and Investments Commission v Avestra Asset Management Ltd (in liq)* (2017) 120 ACSR 247; [2017] FCA 497 at [192] (Beach J).

> Developments in the global financial services industry have given rise to conglomerate firms - which may achieve cost efficiencies by providing a full range of services, and using employees in different capacities across the firm. In seeking these cost efficiencies, it was widely acknowledged by the financial services industry that scope existed for conflicts of interest to arise. Firms responded to these concerns by developing policies and procedures (for example, the establishment of Chinese Walls between different areas of their financial services business) for managing these potential conflicts of interest.[400]

The Explanatory Memorandum to the Bill envisaged two categories of conflicts that would have to be managed:

> - conflicts within the financial services business (Category 1) - examples are conflicts within one area of the financial services business, such as dealing on behalf of various clients, or across different areas of the business, such as between publishing research in a client newsletter and market making;
> - conflicts between something within the financial services business and something outside the financial services business (Category 2) - examples are where outside factors give rise to conflicts within the financial services business, such as a conflict of interest between the financial services licensee lending (as principal) to a particular enterprise and the financial services licensee underwriting a public offer for the same enterprise. Alternatively, a conflict may arise where the objectivity of research is compromised by the analyst's personal interests or relationships.[401]

In its guidance on s 912A(1)(aa) of the Corporations Act, ASIC defines conflicts of interest as ‘circumstances where some or all of the interests of people (clients) to whom a licensee (or its representative) provides financial services are inconsistent with, or diverge from, some or all of the interests of the licensee or its representatives. This includes actual,

[400] These developments can be traced back to the beginnings of financial deregulation in the 1980s. As early as 1990 there was a reference to the UK Law Commission to inquire into the relationship between fiduciary duties and regulatory rules; the Commission noted that ‘Situations in which professionals and businesses appear to owe conflicting duties to different customers or in which there is a conflict between their own interests and those of their customers are not new. However, the potential for such conflicts increased as a result of the changes to the structure of the financial markets in the mid-l980s, in particular the abolition of the Stock Exchange’s single capacity requirement and the development of financial conglomerates offering a wide range of services.’ The Law Commission UK (Law Com No 236) *Fiduciary Duties and Regulatory Rules* (November 2995) [1.2].

[401] Explanatory Memorandum to the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003, para [5.599]. A third category was outside the scope of the requirements: ‘conflicts outside the financial services business (Category 3) - where a factor outside the financial services business gives rise to a conflict with another factor outside the same financial services business. Examples include where those conflicts might arise between two non-financial services businesses of a merchant bank (for example; corporate lending and dealing on the bank's own behalf). Such conflicts are unrelated to the financial services business’.

apparent and potential conflicts of interest'.[402] Despite this the ASIC policy addresses both interest-duty conflicts and duty-duty conflicts. Its view is that the requirement to have in place adequate arrangements extends to managing 'conflicts between the interests of various clients (existing or potential clients) as well as conflicts between the licensee's own interests and those of their clients. Generally, [licensees] should not provide financial services in a manner calculated to advance one client's interests unfairly ahead of other clients' interests'.[403]

The nature of the statutory conflicts management obligation was considered by Jacobson J in obiter in *Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Ltd (No 4)*.[404] In that case, the relationship between the investment bank and its client was not fiduciary, and the investment banking services were not 'financial services' for the purposes of the statutory requirement.[405] His Honour's observations were adopted by Beach J in *Australian Securities and Investments Commission v Avestra Asset Management Ltd (in liq)*, a case concerning the responsible entity of a registered MIS:

> In *Australian Securities and Investments Commission* v *Citigroup Global Markets Australia Pty Ltd* … Jacobson J made the following observations (at [423]), albeit by way of obiter, which I accept. First, the effective management of conflicts of interest does not require that every possible conflict of interest must be eliminated, although that course is open to a financial services licensee. The reference to 'management' of conflicts of interests assumes that some potential conflicts may be managed through implementing adequate arrangements that stop short of eliminating the conflict of interest (at [444] and [445]). And even in a fiduciary situation, adequate arrangements for the management of conflicts of interest does not always require the elimination of conflicts of interest for which the beneficiaries' express consent has not been obtained (at [443]). Second, whether particular arrangements are adequate is to be determined as a question of fact in each case (at [446]). Third, adequate arrangements require more than a raft of written policies and procedures. They require a thorough understanding of the procedures

[402] Australian Securities and Investments Commission, *Regulatory Guide 181 – Managing conflicts of interest* (August 2004). This is one of the few Regulatory Guides that has not been revised by ASIC since issue.
[403] Ibid, [181.41].
[404] *Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Ltd (No 4)* (2007) 160 FCR 35; 241 ALR 705; 62 ACSR 427; [2007] FCA 963. See Pamela Hanrahan, "*ASIC v Citigroup*: Investment Banks, Conflicts of Interest and Chinese Walls" in Justin O'Brien (ed) *Private Equity, Corporate Governance and the Dynamics of Capital Market Regulation* (Imperial College Press, London, 2007).
[405] Because of the carve-out in *Corporations Regulations 2001* (Cth) reg 7.1.29(3)(c).

> by all employees and a willingness and ability to apply them to a host of possible conflicts (at [454]).[406]

To this, his Honour added the following observations:

> (a) First, whether arrangements are adequate will depend upon the nature, scale and complexity of the licensee's business. Moreover, although s 912A(1)(aa) does not import the full stringency of equitable constraints upon a fiduciary acting in a conflict of interest situation, the fact that a financial services licensee is in a fiduciary position (see also s 601FC(2)) will inform what arrangements are adequate.
>
> (b) Second, the obligation to manage conflicts of interest is more than simply an obligation of disclosure to clients or beneficiaries.
>
> (c) Third, the effective management of conflicts of interest will involve a combination of avoiding, controlling and disclosing conflicts of interest.
>
> (d) Fourth, controlling a conflict of interest requires a licensee to first identify, assess and evaluate a conflict of interest and then to decide on and implement an appropriate response. Moreover, any arrangement in response must be regularly monitored to ensure that its implementation is effective.
>
> (e) Fifth, in some cases, the potential impact on a licensee or third parties will be so serious that a conflict of interest cannot effectively be managed by disclosing it and imposing effective internal controls. In such cases, the only way to adequately manage such a conflict of interest may be to avoid it.
>
> (f) Sixth, where disclosure is used as a means of managing a conflict of interest, the disclosure must be made to the affected persons in a timely, prominent, specific and meaningful way. The concept of 'meaningful' connotes something comprehensible to the expected reasonable reader or audience. It also connotes something targeted in terms of its usefulness to the reasonable reader or audience. Further, its informational content ought cover the probability of the conflict occurring and the likely magnitude of its consequences if it does occur in terms of the potential advantages and disadvantages to those who generated the conflict or are participants or beneficiaries therein, or those to whom the disclosure is made. And for those to whom the disclosure is being made, reference should be made to any realistic steps that such a person can take (if any) to ameliorate the conflict's effects.[407]

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[406] *Australian Securities and Investments Commission v Avestra Asset Management Ltd (in liq)* (2017) 120 ACSR 247; [2017] FCA 497 at [193].

[407] *Australian Securities and Investments Commission v Avestra Asset Management Ltd (in liq)* (2017) 120 ACSR 247; [2017] FCA 497 at [194].

This suggests that, even outside the fiduciary context, an AFS licensee cannot meet its statutory conflicts management obligations simply by providing the disclosure required (for retail clients) in the FSG.[408] But it is submitted that the statutory conflicts management obligation does not *of itself* require the AFS licensee to give up (or ensure its representative gives up) its own interest, or to prioritise the client's interests, when it does not otherwise have a legal obligation to do so.[409]

Conflicts management in the fiduciary context

When a licensee or authorised representative is a fiduciary, the fiduciary principles outlined in Section 3.3 above apply.

It is a defence to a claim for breach of fiduciary duty that the client had given its fully informed consent to the licensee or representative acting despite the existence of the potential conflict. The fact that informed consent operates as a defence is important. As Leeming JA pointed out in *Hasler v Singtel Optus Pty Ltd:*

> Fully informed consent is a *defence*. It is a question of fact which depends on all the circumstances of the case: *Maguire v Makaronis* (1997) 188 CLR 449; [1997] HCA 23 at CLR 466. It is for the fiduciary to make it out. It may not be determined until the end of the trial, and may depend upon a complex assessment of the facts. For example, the fiduciary may assert, and the principal deny, that consent was ever sought or given, or that if it was given, that it was fully informed.[410]

Disclosure on its own is not enough; there must be consent. The consent may be express or implied.[411] In *Blackmagic Design Pty Ltd v Overliese*, Besanko J said:

> there is undoubtedly a breach when the fiduciary places himself or herself in a position of conflict. The breach is excused or perhaps does

[408] The matters to be included in the FSG are discussed at Section 3.8 above.
[409] Such an obligation may arise under fiduciary principles or from a specific statutory 'best interests' obligation like that imposed on responsible entities and their officers by *Corporations Act 2001* (Cth) ss 601FC and 601FD; on financial advice providers by *Corporations Act 2001* (Cth) Pt 7.7A, Div 2; on RSE licensees and their directors by operation of ss 52 and 52A of the *Superannuation Industry (Supervision) Act 1993* (Cth) and the requirements imposed on RSE licensees by Australian Prudential Regulation Authority, *Prudential Standard SPS 521 - Conflicts of interest* (July 2013); or on life insurers and their directors in relation to the management of the statutory fund, set out in ss 32(1)(b) and 48(2)(b) of the *Life Insurance Act 1995* (Cth).
[410] *Hasler v Singtel Optus Pty Ltd* (2014) 101 ACSR 167; [2014] NSWCA 266 at [135].
[411] *Kelly v Cooper* [1993] AC 205.

> not arise if the principal consents. In other words, it is not enough that there be disclosure, there must be consent. Disclosure is part of a defence.[412]

The licensee has the onus of proving that it obtained the client's consent.[413]

That consent must be fully informed. In an advice relationship, where the conflict goes to the heart of the thing that is being advised upon, the burden in equity to establish informed consent is high, particularly where the client is unsophisticated. For example, in solicitor-client cases, courts have required that the client be separately advised in relation to that to which it is being asked to consent. As noted above, in *Maguire v Makaronis*, Brennan CJ, Gaudron, McHugh and Gummow JJ said:

> What is required for a fully informed consent is a question of fact in all the circumstances of each case and there is no precise formula which will determine in all cases if fully informed consent has been given. The circumstances of the case may include (as they would have here) the importance of obtaining independent and skilled advice from a third party.[414]

In *Wingecarribee*, Rares J summarised the requirement for informed consent in these terms:

> Thus, a defence to a claim of breach of fiduciary duty is that the person to whom the duty was owed was fully informed as to the nature and extent of the fiduciary's interest and or conflict of interest or duty and then consented to the fiduciary's conduct: see too *Blackmagic Design Pty Ltd v Overliese* …. Importantly, as Gleeson CJ, Gummow, Callinan, Heydon and Crennan JJ observed in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89 at 138–139 [107] the sufficiency of disclosure can depend on the sophistication and intelligence of the persons to whom disclosure must be made. They said that this formed part of the factual inquiry referred to in the first sentence quoted above from *Maguire* 188 CLR at 466.[415]

[412] *Blackmagic Design Pty Ltd v Overliese* (2011) 191 FCR 1; [2011] FCAFC 24 at [108] (Finkelstein and Jacobson JJ agreeing).
[413] *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* (2012) 301 ALR 1; [2012] FCA 1028 at [937].
[414] *Maguire v Makaronis* (1997) 188 CLR 449; [1997] HCA 23 at CLR 466.
[415] *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* (2012) 301 ALR 1; [2012] FCA 1028 at [742].

When financial services are provided to retail clients, the document they receive before or when the relationship is formed is the FSG. The information given in the FSG about associations and about remuneration, commissions and benefits may be general, or framed in terms of examples.[416] Precise comparative information about the different outcomes for the licensee and the client depending on the advice given, the remuneration model adopted, or the financial product issuer or platform provider selected, is not provided. Disclosure that something 'may' happen in future is particularly unsatisfactory. 'May' can imply either that something is permitted, or that something might come to pass if a particular state of affairs exists in future.[417] This raises questions about whether the disclosure provided in the FSG is sufficient on its own or in conjunction with the later-provided SoA to be the basis of *fully informed* consent.

The quality of the disclosure underpinning consent is particularly important in the context of conflicts in the provision of financial advice. Clients don't know what they don't know. As Jagot J accepted in *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)*, 'it is not for the beneficiary of the fiduciary relationship to ask the right questions in order to discover the conflict, it is up to the fiduciary to make full disclosure and seek the informed consent of the beneficiary to proceed with the transaction notwithstanding the conflict'. [418]

The problem, of course, is exacerbated when the licensee or authorised representative does not provide even the prescribed information.[419]

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[416] *Corporations Regulations 2001* (Cth) reg 7.7.03A, 7.7.04, 7.7.04A, 7.7.04AA and 7.7.AB.
[417] *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* (2012) 301 ALR 1; [2012] FCA 1028 at [746].
[418] *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200 at [2310]; upheld *ABN Amro Bank NV v Bathurst Regional Council* (2014) 309 ALR 445; [2014] FCAFC 65.
[419] In July 2017, ASIC announced that it had investigated a number of advice licensees within the National Australia Bank Group for failing to disclose relationships between advisers, advice licensees, and other members of the NAB Group that issue investment products. The non-disclosure occurred when customers were advised to acquire products issued by NAB Group-related firms, including MLC-branded products. Customers were provided with SoAs and FSGs by their financial advisers that did not fully disclose the connection between each customer's adviser, the advice licensee, and recommended investments, as required by the legislation. At least 150,000 customers received deficient disclosure. The only corrective action required by ASIC appears to have been that affected customers would 'receive corrective disclosure'. See Australian Securities and Investments Commission, 17-229MR "NAB makes corrective disclosure to customers about relationships within

Even if disclosure is made, a significant body of recent academic research, particularly in behavioural economics, indicates that disclosure of the kind prescribed by Chapter 7 of the Corporations Act (which focuses on the potential source of the conflict) does not result in retail clients understanding the nature and implications of the conflict. Often clients simply do not read or understand the disclosure.[420] Clients of AFS licensees that sit inside vertically integrated financial institutions may wrongly think the licensee is independent.[421] Studies in financial literacy indicate that many retail clients find it difficult to calculate percentages and, in particular, to understand the quantum and impact of trailing commissions that extend into the future.[422]

There is, arguably, a deeper problem with using disclosure and consent as the primary mechanism for addressing conflicts. If the purpose of disclosing the potential conflict is to alert the client to the risk that, consciously or otherwise, the adviser might be deflected from its duty to act in the interests of the client, it may be having the opposite effect. An adviser telling a person about commercial arrangements that may cause a conflict may, perversely, make the person more trusting of the adviser and less likely to scrutinize the advice given, or more likely to follow the adviser's recommendation to demonstrate reciprocal good faith.[423] Mandatory disclosure may suggest to clients that the government is looking after their interests, making them less vigilant.[424]

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its wealth management business" (7 July 2017). In equity, the bank would be required to refund the advice fee.

420 Interestingly, in a different context, ASIC has expressed the view that 'We would not generally consider that a commission was entered into with the clear consent of or at the direction of the client merely because it has been disclosed in the SOA': ASIC *Regulatory Guide 245 – Fee disclosure statements*, March 2013 at [RG 245.38].

421 Ray Morgan Research "Confusion with financial planner independence continues", Finding 5716, August 2014. Available at http://www.roymorgan.com/findings/5716-confusion-with-financial-planner-independence-201408040221.

422 Australian Securities and Investments Commission, *Report 230: Financial literacy and behavioural change* (March 2011).

423 See e.g. D M Cain, G Loewenstein and DA Moore, "The dirt on coming clean: Perverse effects of disclosing conflicts of interest" (2005) 34(1) *Journal of Legal Studies* 1-25; D M Cain, G Loewenstein and DA Moore, "When sunlight fails to disinfect: understanding the perverse effects of disclosing conflicts of interest" (2011) 37(5) *Journal of Consumer Research* 836-857; N Chater, S Huck and R Inderst *Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective* Report to the European Commission (SANCO) (2010); J L Klass "Investment Adviser Conflicts of Interest Disclosures", Investment Adviser Association Annual Compliance Workshop, New York (2008); S Pearson, K Kleinman, D Rusinak and W Levinson, "A Trial of Disclosing Physicians' Financial Incentives to Patients" (2006) 166(6) *Archives of Internal Medicine* 623–628.

424 K C Green and J S Armstrong, "Evidence on the Effects of Mandatory Disclaimers in Advertising" (2012) 31(2) *Journal of Public Policy and Marketing* 293–304.

These factors may have contributed to the observation in the Murray FSI Interim Report that ‘although disclosure can be an effective regulatory tool, it is currently applied in many instances where it may not be the best tool to overcome a particular market problem. For example, disclosure has not been effective in addressing conflicts of interest.’[425]

[425] Murray FSI Interim Report, above n 55, [3-56].

Annexure A: Legislative timeline

	2004	FSR transition ends
	2005	FSR refinements
		Statutory conflicts management obligation
	2006	
	2007	Simpler Regulatory System reforms
		Enhanced fee disclosure
Global Financial Crisis	2008	
Ripoll Report	2009	
	2010	Margin lending reforms
		Simple PDS reforms
		ASIC Act reforms
Cooper Review of Superannuation		
	2011	
	2012	FoFA reforms (best interests and remuneration for personal advice)
	2013	Limited AFS licensing for accountants
Performance of ASIC Report	2014	
Murray FSI		
		Simple corporate bonds reforms
	2015	Financial adviser register
	2016	
Ramsay Review of EDR	2017	
Productivity Commission review of competitiveness in superannuation		
ASIC Enforcement Review		
	2018	Life insurance commissions reforms
Productivity Commission inquiry into competition in the financial sector		

Annexure B: Reforms foreshadowed but not yet in full effect

These law reforms are currently underway:

- Higher standards for financial advisers
- External dispute resolution arrangements
- Product design and distribution obligations, and ASIC product intervention power
- Changes to structure and powers of ASIC

Reform	Summary of proposals	Current status
Higher standards for financial advisers	Announced February 2017. Intended to 'lift the professional, education and ethical standards of financial advisers'. The reforms include: • compulsory education requirements for new and existing financial advisers • supervision requirements for new advisers • a code of ethics for the industry • an exam that will represent a common benchmark across the industry and • an ongoing professional development component. The reforms establish a commonwealth standard setting body (FASEA) to govern the professional standing of the financial advice sector. FASEA will set the educational requirements, develop and set the exam and create the uniform Code of Ethics. The new requirements will commence on 1 January 2019. From this date, new advisers will be required to hold a relevant degree before they are eligible to commence the supervision year and to sit the exam. Existing advisers will have two years, until 1 January 2021, to pass the exam and five years, until 1 January 2024, to reach a standard equivalent to a degree. The transition period recognises that existing advisers may need to complete the education requirements on a part-time basis while continuing to service their existing clients. The Code of Ethics will commence on 1 January 2020.	*Corporations Amendment (Professional Standards of Financial Advisers) Act 2017* (Cth) FASEA Chair appointed April 2017 FASEA CEO appointed August 2017 Draft education standards released by FASEA March 2018

Reform	Summary of proposals	Current status
New external dispute resolution arrangements for consumers and small business	Announced after the delivery of Ramsay Review interim report in December 2016. Establishes the Australian Financial Complaints Authority (AFCA), a one-stop shop external dispute resolution scheme to hear and determine all financial and superannuation disputes. AFCA will replace the Superannuation Complaints Tribunal, the Financial Ombudsman Service and the Credit and Investment Ombudsman. It will operate under significantly higher monetary limits and compensation caps. Expected to begin hearing disputes from November 2018.	Appointment of AFCA transition team Chair, July 2017 Consultation Paper on the terms of reference, governance and funding arrangements, November 2017 *Treasury Laws Amendment (Putting Consumers First—Establishment of the Australian Financial Complaints Authority) Act 2018* (Cth)

Reform	Summary of proposals	Current status
Increasing the accountability of financial product issuers and distributors	Announced December 2016. Adopts two key proposals from the Murray FSI: • introduction of design and distribution obligations on issuers and distributors • product intervention power for ASIC. Intended to ensure that financial products are targeted and sold to the right consumers, and where products are inappropriately targeted or sold, ASIC will be empowered to intervene in the distribution of the product to prevent harm to consumers. Design and distribution obligations will require issuers of financial products to retail clients to: • identify target markets for their products, having regard to the features of products and consumers in those markets; • select appropriate distribution channels; and • periodically review arrangements to ensure they continue to be appropriate. • put in place reasonable controls to ensure products are distributed in accordance with the identified target markets; and • comply with reasonable requests for information from the issuer in relation to the product's review. Product intervention power will enable ASIC to intervene in the distribution of a product where it perceives a risk of significant consumer detriment, including: • requiring the amendment of product marketing and disclosure materials; • imposing consumer warnings and labelling changes; • restricting how a product is distributed; and • banning products.	Consultation Paper released December 2016 Exposure draft of the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017 released December 2017

Reform	Summary of proposals	Current status
Changes to ASIC	ASIC industry funding model introduced from 2017.	*ASIC Supervisory Cost Recovery Levy Act 2017* (Cth) First phase (industry levies to recover the costs of ASIC's regulatory activities) commenced 1 July 2017. Consultation Paper on second phase (recovery of ASIC regulatory costs that are directly attributable to a single, identifiable, entity) released November 2017
	ASIC Enforcement Review established October 2016. During 2017. consulted on: breach reporting by licensees; industry codes in the financial sector; ASIC licensing powers; search warrants and access to telecommunications intercept materials; ASIC banning powers; ASIC directions powers; penalties for corporate and financial sector misconduct.	Reported to the Minister in December 2017 (report not yet released publicly)
	Changes to structure and staffing of ASIC, through creation of additional Deputy Chair role and removing the requirement for ASIC to employ staff under the *Public Service Act 1999* (Cth).	Treasury Laws Amendment (Enhancing ASIC's Capabilities) Bill 2018 introduced March 2018