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Financial Advice in Australia: Principles to Proscription; Managing to Banning

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FINANCIAL ADVICE IN AUSTRALIA: PRINCIPLES TO PROSCRIPTION; MANAGING TO BANNING

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Australia has put in place a new regulatory system for providing advice that modifies existing obligations and introduces new requirements. The three planks of the new regime are as follows: (1) a statutory obligation that advisers act in the best interests of the client and, in the case of any conflict, give priority to the interests of the client; (2) a ban on conflicted remuneration; and (3) new arrangements for ongoing fees that require the client to opt-in. This new regime is found in consumer protection legislation which does not generally apply directly to commercial relationships and wholesale clients. It is changing financial planners' conduct of business and particularly their remuneration models. Whether it will lead to readily available, properly priced, better advice from trusted financial planners can only be assessed in the future. The changes to the remuneration and fee rules are more likely to drive change and have a bigger impact than the reworked appropriate advice rules.

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I. FUTURE OF FINANCIAL ADVICE

Financial advice is vital due to the compulsory superannuation system in Australia.[1] By law, superannuation funds are trusts.[2] There is choice of fund, for profit and not-for-profit funds, self-managed superannuation funds, and payouts of large lump sums. Individuals also use financial advisers to access managed funds. The policy and regulatory vision is that individuals should be responsible for market risk,[3] though there are caveats to this policy. Australian financial services regulation distinguishes between retail clients and others.[4] There are extensive protections specifically for retail clients.[5] In addition, policy makers and regulators recognize two factors—limited financial literacy and individual decision-making biases.[6] One solution is to encourage retail clients to use professional advisers. However, certain commentators believe this solution is

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[1] At the end of 2011 the industry managed 1.4 trillion AUD. AUSTRALIAN GOV'T, STRONGER SUPER: INFORMATION PACK, at v (2011). {Treasury, *Stronger Super Information Pack* (21 September 2011) v.} The Productivity Commission estimated this at 1.3 trillion AUD and as equivalent to Australia's gross domestic product ("GDP"); it is expected that by 2040 this will be 150% of Australia's GDP. AUSTRALIAN GOV'T PRODUCTIVITY COMM'N, PRODUCTIVITY COMMISSION DRAFT REPORT: DEFAULT SUPERANNUATION FUNDS IN MODERN AWARDS 27 (2012). {Australian Government Productivity Commission, *Draft Report—Default Superannuation Funds in Modern Awards* (June 2012) 27f.} The superannuation system is linked to recognizing incentives to save for retirement as Australia does not have a universal pension system.

[2] *See, e.g.*, Daniel Mendoza-Jones, *Superannuation Trustees: Governance, Best Interests, Conflicts of Interest and the Proposed Reforms*, 30 COMPANY & SEC. L.J. 297, 298 (2012). {See, for example, Daniel Mendoza-Jones, 'Superannuation Trustees: Governance, Best Interests, Conflicts of Interest and the Proposed Reforms' (2012) 30 *Company and Securities Law Journal* 297.}

[3] For a summary of the question of where the responsibility should lie, see Dimity Kingsford Smith, *ASIC Regulation for the Investor as Consumer*, 29 COMPANY & SEC. L.J. 327, 353 (2011) {see D Kingsford-Smith, 'ASIC Regulation for the Investor as Consumer' (2011) 29 *Company and Securities Law Journal* 327, 353}.

[4] *See generally Corporations Act 2001* (Cth) ch 7 (Austl.). {*Corporations Act 2001* (Cth) Chapter 7.} Section 761 defines providing a financial service to a retail client. *Id.* s 761G. {Ibid s 761G.}

[5] These protections include extensive disclosure about providers and issuers, products and advice in financial services guides, product disclosure statements, and statements of advice; market conduct rules, and availability of compensation.

[6] *See* AUSTRALIAN GOV'T PRODUCTIVITY COMM'N, *supra* note 1, at 4. {Australian Government Productivity Commission, *Draft Report*, above n 1, 4.}

contradicted by evidence of advice being given without a reasonable basis for that advice,[7] conflicted remuneration,[8] and losses so significant they led to a Parliamentary inquiry.[9]

This inquiry identified a number of areas of concern over the regulation of financial services, including the inadequacy of disclosure and conduct standards, the competency requirements for licensees, and the need for enhanced enforcement. The inquiry recommended changes to regulation of the advice industry, including an explicit legislative fiduciary duty and more targeted financial literacy programs.[10] The committee noted that remuneration within the industry was incompatible with a fiduciary duty. It proposed that government should consult on strategies to remove commissions and, in particular, recommended an end to payments from financial product manufacturers to financial advisers.[11] The key idea was that by eliminating commissions and finding a way to ensure advisers

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[7] In a shadow shopping exercise published in 2012, the Australian Securities and Investments Commission ("ASIC") found that thirty-nine percent of the sample did not meet the legislative requirement to have a reasonable basis for the advice and the standard of "appropriate." AUSTRALIAN SEC. & INVS. COMM'N, REPORT 279, SHADOW SHOPPING STUDY OF RETIREMENT ADVICE 31–33 (2012). {Australian Securities and Investments Commission, *Shadow Shopping Study of Retirement Advice*, Report 279 (March 2012) 31, 33.} On the role that financial advisers played in the high profile collapses of Storm Financial and Opes Prime, see PARLIAMENTARY JOINT COMM. ON CORPS. & FIN. SERVS., INQUIRY INTO FINANCIAL PRODUCTS AND SERVICES IN AUSTRALIA 19–67 (2009) [hereinafter RIPOLL REPORT], *available at* http://www.aph.gov.au/binaries/senate/committee/corporations_ctte/fps/report/report.pdf {Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Financial Products and Services in Australia* ('Ripoll Report') (November 2009) Chapters 3–4 at http://www.aph.gov.au/binaries/senate/committee/corporations_ctte/fps/report/report.pdf}.

[8] See Gerard Craddock, *The Ripoll Committee Recommendation for a Fiduciary Duty in the Broader Regulatory Context*, 30 COMPANY & SEC. L.J. 216, 216–19 (2012) {Gerard Craddock, SC, 'The Ripoll Committee Recommendation for a Fiduciary Duty in the Broader Regulatory Context' (2012) 30 *Company and Securities Law Journal* 216, 216–9}, for a statement of the problem of conflicted remuneration particularly as revealed through statements in the Financial Services Guides of financial planners. The Financial Services Guide is a mandatory disclosure document that must be given by financial services licensees to retail clients. *Corporations Act 2001* (Cth) s 941A (Austl.). {*Corporations Act 2001* (Cth) s 941A.}

[9] *See generally* RIPOLL REPORT, *supra* note 7. {Ripoll Report, above n 7.}

[10] *See id.* at 100–01, 105–06, 150. {Ibid.} For recommended changes to fiduciary duty, see *id.* at 103–06, 150 {Ripoll Report Recommendation 1, 150, 103f, 110f}. For recommendations regarding financial literacy programs, see *id.* at 147, 151 {Recommendation 11, 151, 147}.

[11] *Id.* at 127, 151. {Ibid Recommendation 4, 127, 151.}

put the interests of the client first, Australians would get better advice and would not be led into the types of investment schemes that set off the inquiry.

The new Future of Financial Advice ("FOFA") rules do not specifically define the adviser relationship as fiduciary. They have several components: (1) to act in the best interests of the client;[12] (2) to follow prescribed steps to meet the best interests obligation;[13] (3) to reach and give appropriate advice through meeting the best interests obligation;[14] (4) in case of a conflict of interest, to give priority to the interests of the client;[15] (5) to ban conflicted remuneration, volume-based benefits, shelf fees, and asset-based fees on borrowed monies;[16] and (6) to require that every two years, clients must opt-in to any ongoing fee arrangement.[17] The first four obligations are linked and generally fall on individuals.[18] The remuneration rules are not restricted to individuals.[19]

A. *Relationship to Previous Rules*

This new legislation modifies the largely principles-based rules of Chapter 7 of the Corporations Act, which date from 2001 and protect retail clients of financial services. The new legislation contains some completely new rules, replaces others, and retains many. The rules apply to personal advice given to a retail client.[20]

The replaced rules also required financial services licensees to give only "appropriate advice." Under these rules, licensees had to determine the relevant personal circumstance of the client; make reasonable inquiries of those circumstances; with regard to the information obtained from the client, consider the subject matter of the advice and undertake a reasonable

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[12] *Corporations Act 2001* (Cth) s 961B(1) (Austl.). {*Corporations Act 2001* (Cth) s 961B(1).}

[13] *Id.* s 961B(2). {Ibid s 961B(2).}

[14] *Id.* s 961G. {Ibid s 961G.}

[15] *Id.* s 961J. {Ibid s 961J.}

[16] *Id.* ss 963E, 964A, 964D. {Ibid ss 963E, 964A, 964D.}

[17] *Id.* ss 962K, 962L. {Ibid ss 962K, 962L.}

[18] *Id.* s 961. {Ibid s 961.} The obligation may fall on a company where it is not possible to identify an individual provider and where advice is given through a computer. *See id.* s 961(5), (6). {Ibid s 961(5), (6).}

[19] *See, e.g.*, *id.* s 963A. {See, for example, *Corporations Act 2001* (Cth) s 963A.}

[20] *Id.* ss 766B(3), 761G. {Ibid ss 766B(3), 761G.}

investigation of the subject matter of the advice; and, with regard to the consideration and the investigation, give "appropriate" advice.[21] Clients were given a warning if advice was based on incomplete or inaccurate information.[22] Any such warning was given in the mandatory "Statement of Advice."[23] The rules required and still require licensees to have "adequate arrangements for the management of conflicts of interest."[24]

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[21] *Id.* s 945A (repealed 2012). {Ibid s 945A (repealed).} In *Nguyen v Australian Sec. & Invs. Comm'n* [2012] AATA 156, ¶¶ 36–39, 59, 92 (Austl.) {*Nguyen v Australian Securities and Investments Commission* [2012] AATA 156}, a financial adviser with Colonial First State, a subsidiary of the Commonwealth Bank of Australia, was banned for, among other things, a contravention of section 945A by failing to formulate appropriate advice and switching an eighty-three-year-old woman out of a safe wholesale income fund into an international property trust and a wholesale property securities investment that was higher risk and more volatile than fixed interest assets. According to AUSTRALIAN SEC. & INVS. COMM'N, REGULATORY GUIDE 175, LICENSING: FINANCIAL PRODUCT ADVISERS—CONDUCT AND DISCLOSURE 7 (2011) [hereinafter ASIC REGULATORY GUIDE 175] {Note Australian Securities and Investments Commission, *Licensing: Financial Product Advisers — Conduct and Disclosure*, Regulatory Guide 175, April 2011 ('ASIC Regulatory Guide 175') at 175}, 175.16 provided that (a) the providing entity must "make reasonable inquiries about the client's relevant personal circumstances"; (b) the providing entity must "consider and investigate the subject matter of the advice" as is reasonable in all the circumstances; and (c) the advice must be "appropriate" for the client. Also, 175.122 required consideration of the potential impact of inappropriate advice on the client, complexity of the advice, and financial literacy of the client. ASIC REGULATORY GUIDE 175, *supra*, at 36. To ascertain the circumstances of the client, 175.125 required looking at the client's (a) need for regular income—for example, retirement income; (b) need for capital growth; (c) desire to minimize fees and costs; (d) tolerance of the risk of capital loss, especially where this is a significant possibility if the advice is followed; (e) tolerance of the risk that the advice, if followed, will not produce the expected benefits; (f) existing investment portfolio; (g) need to be able to readily cash-in the investment; (h) capacity to service any loan provided in relation to a financial product; and (i) tax position, social security entitlements, family commitments, employment security, and expected retirement age. *Id.* at 37. This 2011 Regulatory Guide updated earlier versions and has itself been updated in December 2012 and October 2013.

[22] *Corporations Act 2001* (Cth) s 945B (Austl.) (repealed 2012). {*Corporations Act 2001* (Cth) s 945B (repealed).}

[23] *Id.* ss 947B–947C. {Ibid ss 947B (amended), 947C (amended).}

[24] *Id.* s 912A. {Ibid s 912A.} This obligation is a condition of holding an Australian Financial Services Licence. *See id.* s 912A(1)(aa). {*Corporations Act 2001* (Cth) s 912A 1(aa).} For a discussion on the management of conflicts of duty and interest, see generally AUSTRALIAN SEC. & INVS. COMM'N, REGULATORY GUIDE 181, LICENSING: MANAGING CONFLICTS OF INTEREST (2004) {Australian Securities and Investments Commission, *Licensing: Managing Conflicts of Interest,* Regulatory Guide 181 ('ASIC Regulatory Guide 181')}; AUSTRALIAN PRUDENTIAL REGULATION AUTH., PRUDENTIAL PRACTICE GUIDE DRAFT: SPG 521—CONFLICTS OF INTEREST (2012) {Australian Prudential Regulation Authority, *Prudential Practice Guide Draft*

Licensees must disclose information about relationships with others reasonably expected to be capable of influencing the providing entity in providing the service[25] and must also provide information about remuneration, including commissions or other benefits.[26]

Previously there was a criminal sanction for contravention of the pre-existing statutory "appropriate advice" prohibition.[27] Now, a contravention of the best interests and client priority rules may result in a civil penalty, an order to compensate the client for loss or damage, restitution, and an order declaring the contract void.[28]

All contracts for the provision of financial services to a consumer still contain an implied non-excludable term that the services will be rendered with due care and skill, and, if the consumer expressly or impliedly makes known the purpose or desired results to the person who supplied the service, the services will be fit for that purpose or shall be of such quality to reasonably achieve that result.[29]

The new legislation addresses some of the problems inherent in the confusion between sales and advice[30] but will not necessarily ensure suitable or the best quality advice.[31] It may

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SPG 521 — Conflicts of Interest (April 2012)}. Inability to recognize a conflict of interest goes to suitability to hold a financial services license. *Kofkin v. Australian Cos. & Sec. Comm'n* [2009] AATA 660, ¶ 54 (Austl.). {*Kofkin v Australian Companies and Securities Commission* [2009] AATA 660 at [54].} The view that disclosure has been inadequate to manage conflicts of interest informed the *Ripoll Report* which preceded the FOFA legislation. RIPOLL REPORT, *supra* note 7, at 111–12. {Ripoll Report, above n 7, 111–2.}

[25] *Corporations Act 2001* (Cth) s 942B(2)(f) (Austl.). {*Corporations Act 2001* (Cth) s 942B(2)(f).}

[26] *Id.* s 942B(2)(e). {Ibid s 942B(2)(e).}

[27] *Id.* ss 945A (repealed 2012), 1311(1). {Ibid s 945A (repealed); s 1311(1).}

[28] *Id.* ss 961K, 961M, 961N. {*Corporations Act 2001* (Cth) ss 961K, 961M, 961N.}

[29] *Securities and Investments Commission Act 2001* (Cth) s 12ED (Austl.). {*Australian Securities and Investments Commission Act 2001* (Cth) s 12 ED.}

[30] GAIL PEARSON, FINANCIAL SERVICES LAW AND COMPLIANCE IN AUSTRALIA 200 (2009). {G Pearson, *Financial Services Law and Compliance in Australia* (Cambridge University Press, 2009) 200.} *The Ripoll Report* subsequently asked if advice about financial products was a sales industry or an advice industry and noted that consumers cannot discern if planners are simply sales agents or independent advisers. RIPOLL REPORT, *supra* note 7, at 69, 83. {Ripoll Report, above n 7, 69, 83.}

[31] Note ASIC REGULATORY GUIDE 175, *supra* note 21, at 34–35 {ASIC Regulatory Guide 175, above n 21}, which in 175.113 referred to *Corporations Act 2001* (Cth) s 945A (Austl.) (repealed 2012) {*Corporations Act 2001* (Cth) s 945A (repealed)} as a suitability rule, and also in 175.117, said that the advice does not have to be ideal, perfect, or best. Yet ASIC proposes that "it would be reasonable to

limit some conflicts and will alter some remuneration practices. FOFA is attributed with altering the structure of the advice industry.[32] In some respects it may be no more, and perhaps even less, protective than legislation it has replaced.

B. *Availability of Financial Advice*

As well as improving the quality of advice, a declared purpose of the new framework is to improve access to financial advice.[33] This purpose is consistent with regulatory objectives to promote confident and informed participation and decision-

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conclude that advice is appropriate if: (a) it is fit for its purpose—that is, following the advice is *likely* to satisfy the client's relevant circumstances; and (b) following the advice is likely to leave the client in a better position." AUSTRALIAN SEC. & INVS. COMM'N, CONSULTATION PAPER 182, FUTURE OF FINANCIAL ADVICE: BEST INTERESTS DUTY AND RELATED OBLIGATIONS—UPDATE TO RG 175, at 19 (2012) [hereinafter ASIC CONSULTATION PAPER 182] (emphasis added). {Australian Securities and Investments Commission, *Future of Financial Advice: Best Interests Duty and Related Obligations — Update to RG 175*, Consultation Paper 182, 9 August 2012 ('ASIC Consultation Paper 182') 19.}

[32] The industry is consolidating through mergers and acquisitions; more dealer groups have become aligned with the big four banks while boutique firms remain, resulting in fewer independent groups. Ruth Liew, *Mergers Squeeze Financial Planner Options*, FIN. REV. (Aug. 29, 2012, 3:26 AM), http://www.afr.com/p/personal_finance/portfolio/mergers_squeeze_financial_planner_LwgrKht7xsMM3AEBLnBV8O. {Ruth Liew, 'Mergers Squeeze Planner Options', *Australian Financial Review* (Sydney), 29 August 2012.} This consolidation may signal a move from a distribution network to an advice network.

[33] Revised Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2012 (Cth) 3 (Austl.) [hereinafter Further FOFA Bill Revised Explanatory Memorandum], *available at* http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22legislation%2Fems%2Fr4739_ems_c1902f04-f76c-455d-87bf-763755860827%22. {Revised Explanatory Memorandum to the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2012 ('Further FOFA Bill Revised Explanatory Memorandum') 3 at <http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22legislation%2Fems%2Fr4739_ems_c1902f04-f76c-455d-87bf-763755860827%22>.} But note that in the Parliament, the Minister stated that while the legislation would lead to better advice, it was primarily "about regulating conflicts, not the intrinsic value of the advice provided." PARLIAMENTARY JOINT COMM. ON CORPS. & FIN. SERVS., CORPORATIONS AMENDMENT (FUTURE OF FINANCIAL ADVICE) BILL 2011 AND CORPORATIONS AMENDMENT (FURTHER FUTURE OF FINANCIAL ADVICE MEASURES) BILL 2011, at 22 (2012) [hereinafter PARLIAMENTARY JOINT COMMITTEE INQUIRY AND REPORT]. {Parliamentary Joint Committee on Corporations and Financial Services, Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (February 2012) ('Parliamentary Joint Committee Inquiry and Report') 22.} Many Australians do access financial advice. It was estimated that the twenty largest licensees had four million clients in 2010, 1.5 million of whom were considered active. *Id.* at 2. {Parliamentary Joint Committee Inquiry and Report, 2.}

making by consumers.[34] The financial services regulator, the Australian Securities and Investments Commission ("ASIC"), views access to quality advice as part of risk regulation, a way to reduce risks for consumers and a way to improve market competition and efficiency.[35] ASIC says that, despite high numbers of planners, there is a gap between the advice consumers want and the advice which advisers provide.[36] Advisers are generally not specialists—although they may have access to specialists—and either want or feel compelled to provide comprehensive financial plans for the entirety of a client's financial situation; clients often want targeted or "scaled" advice.[37] Advisers work from approved product lists linked to product platforms but tend to recommend only a few key products.[38]

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[34] *Australian Securities and Investments Commission Act 2001* (Cth) s 1(2)(b) (Austl.) {*Australian Securities and Investments Commission Act 2001* (Cth) s 1(2)(b)}; *Corporations Act 2001* (Cth) s 760A(a) (Austl.) {*Corporations Act 2001* (Cth) s 760A(a)}.

[35] AUSTRALIAN SEC. & INVS. COMM'N, REPORT 224, ACCESS TO FINANCIAL ADVICE IN AUSTRALIA 4, 7, 10 (2010). {Australian Securities and Investments Commission, *Access to Financial Advice in Australia*, Report 224 (December 2010) 4, 7, 10.}

[36] *Id.* at 29. {Ibid 29.}

[37] *Id.* at 32–35. {Ibid 32–5.}

[38] The median number of products on a list was 400. AUSTRALIAN SEC. & INVS. COMM'N, REPORT 251, REVIEW OF FINANCIAL ADVICE INDUSTRY PRACTICE 7, 23 (2011). {Australian Securities and Investments Commission, *Review of Financial Advice Industry Practice*, Report 251 (September 2011) 7, 23.} Product platforms have been described as "a one-stop shop or supermarket for managed funds and other financial instruments." ECON. LEGISLATION COMM., SENATE, CORPORATIONS AMENDMENT (FUTURE OF FINANCIAL ADVICE) BILL 2011 [PROVISIONS] AND CORPORATIONS AMENDMENT (FURTHER FUTURE OF FINANCIAL ADVICE MEASURES) BILL 2011 [PROVISIONS], at xi (2012) [hereinafter SENATE ECONOMICS LEGISLATION COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES]. {The Senate Economics Legislation Committee on Corporations and Financial Services, Corporations Amendment (Future of Financial Advice) Bill 2011 [Provisions] and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 [Provisions] (March 2012) xi.} On platforms, see generally AUSTRALIAN SEC. & INVS. COMM'N, CONSULTATION PAPER 176, REVIEW OF ASIC POLICY ON PLATFORMS: UPDATE TO RG 148 (2012). {See Australian Securities and Investments Commission, *Review of ASIC Policy on Platforms: Update to RG 148*, Consultation Paper 176, March 2012.} RG 148 is about investor-directed portfolio services. An earlier draft version of the legislation included a provision stating that if it was apparent the client required a product not on the approved product list, the adviser did not have to investigate that product. *See* Corporations Amendment (Future of Financial Advice) Bill 2011 (Cth) s 961G (Austl.). {See Exposure Draft, Corporations Amendment (Future of Financial Advice) Bill 2011 (Cth), s 961G.}

Historically, the greatest revenue to planners comes from volume-based remuneration paid by a fund manager or a product provider.[39] In the general community, there is apparently a high level of distrust of financial planners.[40] There is also a significant gap between the cost of advice to planners and the amounts consumers are prepared to pay for advice.[41] A partial explanation may be the range of amounts for which consumers want advice. One of the reasons for the distrust is greater realization within the Australian community of remuneration models which have depended on commissions paid to advisers, including trail commissions.[42] Commissions have been identified as a factor that leads advisers into conflicts of interest and to recommend inappropriate products.[43] They have also been touted

[39] AUSTRALIAN SEC. & INVS. COMM'N, REPORT 251, *supra* note 38, at 11. {Australian Securities and Investments Commission, Report 251, above n 38, 11.}

[40] AUSTRALIAN SEC. & INVS. COMM'N, REPORT 224, *supra* note 35, at 60. {Australian Securities and Investments Commission, Report 224, above n 35, 60.} The Assistant Treasurer and Minister for Financial Services and Superannuation spoke of restoring trust. *See* Marcus Ap, *The Future of Financial Advice Reforms: Restoring Public Trust and Confidence in Financial Advisers—An Unfinished Puzzle*, 10 CANBERRA L. REV. 188, 188 (2011). {Marcus Ap, 'The Future of Financial Advice Reforms: Restoring Public Trust And Confidence in Financial Advisers—An Unfinished Puzzle' (2011) 10 (3) *Canberra Law Review* 188, 188.} This paper also comments on the proposal that use of the term "financial planner" or "financial adviser" should be restricted to those who are members of a professional standards board and on the range of competence within the industry. *See id.* at 189, 194–95. {See 189, 194–5.}

[41] Planners say the average cost is $2,500 to $3,500; consumers are prepared to pay on average $301. AUSTRALIAN SEC. & INVS. COMM'N, REPORT 224, *supra* note 35, at 47. {Australian Securities and Investments Commission, *Report 224*, above n 35, 47.}

[42] Seven in ten planners receive trailing commissions which are usually about 0.6% of account balances. *See* RIPOLL REPORT, *supra* note 7, at 17. {Ripoll Report, above n 7, 17.} This trailing commission might be in addition to a commission on a new investment or contribution of up to four to five percent of the amount invested and a volume bonus of up to 0.25% on an account balance. *Id.* at 27. {Ibid 27.} In addition, advisers may receive soft dollar benefits such as holidays and tickets to sporting events. *Id.* at 75 n.16. {Ibid 75.} Some clients may not understand this ongoing fee, which means that ongoing fees may be charged without relating to current financial advice. PARLIAMENTARY JOINT COMMITTEE INQUIRY AND REPORT, *supra* note 33, at 27 {Parliamentary Joint Committee Inquiry and Report, above n 33, 27}; SENATE ECONOMICS LEGISLATION COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES, *supra* note 38, at 12 {Senate Economics Legislation Committee on Corporations and Financial Services, above n 38, 12}.

[43] The Ripoll inquiry was specifically directed to inquire into commission arrangements. The evidence as reported by the committee divides into submissions pointing to conflicts and churn from regulators, consumer advocates and not-for-profit superannuation funds, and submissions from the advice industry arguing that

as a cross-subsidy of the cost of advice.[44] Policy makers say that regulation should ensure investor protection and affordable advice.[45]

II. THE FIDUCIARY IN AUSTRALIAN LAW

In Australian law, fiduciary duties are proscriptive, not prescriptive.[46] They arise because of the existence of obligations in the particular instance, not because of the relationship.[47] Australian courts have not provided a statement of when persons stand in a fiduciary relationship.[48] Justice Jacobsen famously said, "[P]erhaps the most than can be said is that a fiduciary relationship exists where a person has undertaken to act in the interests of another and not in his or her own interests."[49] If a

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conflicts can be managed and that commissions subsidize the cost of advice. RIPOLL REPORT, *supra* note 7, at vii, 16–17, 66, 76–77. {Ripoll Report, above n 7, vii 16,17,66,76f.}

[44] The Commonwealth Bank of Australia, which owns the planner group Colonial First State, argued that a full plan costs $3,570, that only three percent of superannuation fund members who had recently switched funds were prepared to pay this amount, and that commissions as subsidies ensure consumers have access to advice. *Id.* at 77–78. {Ripoll Report, above n 7, 77–8.} The extent of existing cross-subsidization of advice should be examined, and price controls could be considered.

[45] *Id.* at 75. {Ripoll Report, above n 7, 75.}

[46] *See, e.g.*, *Pilmer v Duke Grp. Ltd.* (2001) 207 CLR 165, 198 (Austl.) {*Pilmer v Duke Group Ltd* (in liq) (2001) 207 CLR 165 at [74]}; *Breen v Williams* (1996) 186 CLR 71, 113 (Austl.) {*Breen v Williams* (1996) 186 CLR 71 at 113}; *Australian Sec. & Invs. Comm'n v Citigroup Global Mkts. Austl. Pty Ltd.* [2007] FCA 963 (Unreported, Jacobson, J., 28 June 2007) ¶ 290 (Austl.) {*Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Limited* (ACN 113 114832) No 4 2007 FCA 963 per Jacobson J}; *Aequitas Ltd. v Sparad No. 100 Ltd.* [2001] NSWSC 14, ¶ 284 (Austl.) {*Aequitas Ltd v AEFC Leasing Pty Ltd* (2001) 19 ACLC 1006 at [284]}. See Craddock, *supra* note 8 {Craddock, above n 8}, for a discussion of differences in fiduciary law in Australia and the United States.

[47] *See generally* P.D. FINN, FIDUCIARY OBLIGATIONS (1977) {P Finn, *Fiduciary Obligations* (Law Book Company, 1977)}; P.D. Finn, *The Fiduciary Principle*, *in* EQUITY, FIDUCIARIES, AND TRUSTS (T. G. Youdan ed., 1989) {P Finn, 'The Fiduciary Principle' in T G Youdan (ed) *Equity, Fiduciaries and Trusts* (Law Book Company, 1989)}. These sources are often judicially cited.

[48] *Breen*, 186 CLR at 106 {*Breen v Williams* (1996) 186 CLR 71 per Gaudron J and McHugh J at 106}; *Hodgson v Amcor Ltd.* (2012) 264 FLR 1, ¶ 1343 (Austl.) {*Hodgson v Amcor; Amcor v Barnes &Ors* [2012] VSC 94 per Vickery J at [1343]}.

[49] *Citigroup Global Mkts. Austl. Pty Ltd.*, [2007] FCA ¶ 272. {*Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Limited (ACN 113 114832) No 4* [2007] FCA 963 per Jacobson J at [272].} However, "[f]iduciary obligations often arise in cases where one person is under an obligation to act in the interests of another, but that does not mean that the obligation to act in the interests of another is a fiduciary obligation." *Aequitas Ltd.*, [2001] NSWSC

fiduciary obligation arises, the proscriptive core is the duty of undivided loyalty not to make an unauthorized profit and not to have a personal interest—or other duty—that is in conflict with the duty.[50] At general law, there is no further positive duty "to act in the interests of the person to whom the duty is owed."[51] The scope of a fiduciary duty will vary according to the nature of the relationship and the facts of the case.[52] A fiduciary duty can co-exist with contractual obligations and may be excluded by them.[53]

An investment adviser is likely to owe a fiduciary duty to a client.[54] Former Judge of the Federal Court of Australia, the

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¶ 284. {*Aequitas Ltd v AEFC Leasing Pty Ltd* (2001) 19 ACLC 1006; [2001] NSWSC 14 per Austin J at [284].}

[50] *Breen*, 186 CLR at 108. {*Breen v Williams* (1996) 186 CLR 71; [1996] HCA 57 per Gaudron and McHugh JJ at [41].} This proscriptive core is described as the no-profit rule and the no-conflict rule. *P & V Indus. Pty Ltd. v Porto* (2006) 14 VR 1, ¶ 12 (Austl.) {*P &V Industries Pty Ltd v Porto [2006]* VSC 131; (2006) 14VR 1 at [12]}; *see also* Kevin Lindgren, *Fiduciary Duty and the Ripoll Report*, 28 COMPANY & SEC. L.J. 435, 441 (2010) {see also K Lindgren, 'Fiduciary Duty and the Ripoll Report' (2010) 28 *Company and Securities Law Journal* 435, 441}.

[51] *Breen*, 186 CLR at 113. {*Breen v Williams* (1996) 186 CLR 71; [1996] HCA 57 per Gaudron and McHugh JJ at [41].}

[52] *Id.* at 82–83 {*Breen v Williams* (1996) 186 CLR 71}; *Hosp. Prods. Ltd. v U.S. Surgical Corp.* (1984) 156 CLR 41, 49 (Austl.) {*Hospital Products Ltd v United States Surgical Cor*p (1984) 156 CLR 41}.

[53] *Citigroup Global Mkts. Austl. Pty Ltd.*, [2007] FCA ¶ 276 {*Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Limited (ACN 113 114832) No 4* [2007] FCA 963}; *Aequitas Ltd.*, [2001] NSWSC ¶ 283 {*Aequitas Ltd v AEFC Leasing Pty Ltd* (2001) 19 ACLC 1006 per Austin J at [287]}; *see* Peter Devonshire, *Account of Profits for Breach of Fiduciary Duty*, 32 SYDNEY L. REV. 389, 393–94 (2010) {see P Devonshire, 'Account of Profits for Breach of Fiduciary Duty' (2010) 32 *Sydney Law Review* 389, 393–4} (discussing limitations to contractual exclusion of fiduciary obligations and the inference that this may be limited to fiduciary relations between commercial parties).

[54] *Daly v Sydney Stock Exch. Ltd.* (1986) 160 CLR 371, 385 (Austl.) {*Daly v The Sydney Stock Exchange* (1986) 160 CLR 371; 1986 HCA 25}; *Citigroup Global Mkts. Austl. Pty Ltd.*, [2007] FCA ¶ 272–85 {*Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Limited (ACN 113 114832) No 4* [2007] FCA 963 per Jacobson J [282]–[285]}; *Tomasetti v Brailey* [2011] NSWSC 1446, ¶ 543 (Austl.) {*Tomasetti v Brailey* [2011] NSWSC 1446}; *Brown v Australian Sec. & Invs. Comm'n* [2009] AATA 286, ¶ 151 (Austl.) {*Brown v Australian Securities and Investments Commission* (2009) 108 ALD 625; [2009] AATA 286}. In *Hadid v Lenfest Commc'ns Inc.* [1999] FCA 1798, ¶ 817 (Austl.) {*Hadid v Lenfest Communications Inc* [1999] FCA 1798 per Lehane J [817]}, Justice Lehane said: "[A]dvisers may, and often do, have fiduciary obligations" and:

> [t]here is little doubt that the principle extends more broadly in the case of advisers whose task it is to counsel 'an advised party as to how his interests will or might best be served in a matter which our society

Honorable Kevin Lindgren QC, points out that a fiduciary duty does not concern the quality or the very best advice.[55] Lindgren says that prescriptive statutory requirements imposed on professionals are akin to a common law duty to exercise reasonable care and skill, breach of which will result in negligence.[56] In other words, they are "quasi-tortious."[57] The obligation to disclose, he says, is not fiduciary per se, but linked to the defense to equitable damages for breach of the no-profit, no-conflict rule which, unlike common law damages, will not be restricted to the loss to the beneficiary but will include the profit made by the fiduciary.[58] By way of contrast with fiduciary law, the prescriptive regulation of advisers requires them to act in a certain way. The legislative proscription of particular forms of remuneration is a further departure from classic fiduciary law.

The language of a statutory "best interests" duty in Australia derives from the trust context of superannuation regulation and the duties of responsible entities of managed funds. Along with fiduciary duties, a trustee of a superannuation fund has a statutory duty to act in the best interests of all beneficiaries of a fund.[59] A responsible entity must act in the best interests of

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> considers to be of importance to the advised's personal or financial well-being' . . . .

Id. (quoting Paul Finn, *Fiduciary Law and the Modern Commercial World*, *in* COMMERCIAL ASPECTS OF TRUSTS AND FIDUCIARY OBLIGATIONS 7, 10–11 (Ewan McKendrick ed., 1992) {Finn, "Fiduciary Law and the Modern Commercial World" in [E McKendrick, *Commercial Aspects of Trusts and Fiduciary Obligations*, 1992], pp 10, 11'}).

[55] *See* Lindgren, *supra* note 50, at 438. {Lindgren, above n 50, 435, 436–8.} However, note that in *Daly*, 160 CLR at 385 {*Daly v the Sydney Stock Exchange* (1986) 160 CLR 371; [1986] HCA 25}, Justice Brennan said that in the case of a financial adviser who gives advice on an investment in which the adviser has a financial interest the duty is "to give the best advice which the adviser could give."

[56] *See* Lindgren, *supra* note 50, at 436–38. {Lindgren, above n 50, 435–6, 438.}

[57] *Pilmer v Duke Grp. Ltd.* (2001) 207 CLR 165, 197–98 (Austl.). {*Pilmer v Duke Group ltd (in liq)* (2001) 207 CLR 165 at [74].}

[58] Lindgren, *supra* note 50, at 435, 438. {Lindgren, above n 50, 435, 438.}

[59] *See Superannuation Industry (Supervision) Act 1993* (Cth) s 52(2)(c) (Austl.). {*Superannuation Industry (Supervision) Act 1993* (Cth) s 52(2)(c).} There is also a statutory obligation that company directors should act in good faith and in the best interests of the company. *See Corporations Act 2001* (Cth) s 180(1)(a) (Austl.). {*Corporations Act 2001 (Cth)* s 180(1)(a).} Litigation has tended to concern associated obligations to act for a proper purpose. *See, e.g.*, *Australian Sec. & Invs. Comm'n v Adler* [2002] NSWSC 171, ¶ 8 (Austl.). {See, for example, *ASIC v Adler* [2002] NSWSC 171.} In *Adler*, Justice Santow referred to the statutory business judgment rule as a "safe harbour," language also used by ASIC to describe the best interests steps by financial advisers in section 961B(2). *Id.* {Ibid}

members and, in the case of a conflict, give priority to members' interests.[60] The superannuation provision is concerned with the discretionary powers of the trustee. The fiduciary duty and the statutory duty have been treated as coterminus, importing the equitable duty into a statute. It has been held that this superannuation statutory duty imposes no higher standard on a trustee than that of the general law,[61] and that the general law obligation could be expressed as it is in the language of the statute.[62] Unlike the trustee of a superannuation fund, a financial adviser in the capacity of giving advice is not a trustee, and it is unlikely that the financial adviser's statutory duty is identical to a fiduciary duty.

The lack of clarity surrounding the best interests duty is compounded by ASIC, which assumes that the new FOFA laws express a legislative fiduciary duty,[63] yet at the same time intends to administer the best interests duty in the light of other obligations, which may include "common law obligations such as the duty of care and fiduciary duties."[64]

Two recent Federal Court decisions found breaches of fiduciary duty in circumstances of financial advice.[65] Both involved the sale of complex financial products to relatively unsophisticated local government councils in the lead up to the

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[60] *Corporations Act 2001* (Cth) s 601FC(1)(c) (Austl.). {*Corporations Act 2001* (Cth) s 601FC (1)(c).}

[61] *Invensys Austl. Superannuation Fund Pty Ltd. v Austrac Invs. Ltd.* (2006) 198 FLR 302, 323–24, ¶¶ 102–07. {*Invensys Australia Superannuation Fund Pty Ltd v Austrac Investments Ltd* [2006] VSC 112; [2006] 15 VR 87 at[102]-[107].} *Cowan v Scargill* [1984] 2 All ER 750 (Austl.) {*Cowan v Scargill* [1984] 2 All ER 750} analyzes the duties of a trustee of a pension fund; but as with superannuation funds, this concerns the power to invest, not the giving of advice.

[62] *Manglicmot v Commonwealth Bank Officers Superannuation Corp. Pty Ltd.* (2011) 282 ALR 167, ¶ 121 (Austl.). {*Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* [2011] NSWCA 204 per Giles JA at [121].}

[63] *See* ASIC CONSULTATION PAPER 182, *supra* note 31, at 6–7. {ASIC Consultation Paper 182, above n 31, 6–7.} For a critique of ASIC's approach to fiduciary law, see Craddock, *supra* note 8, at 221 {see Craddock, above n 8, 221}.

[64] *See* ASIC CONSULTATION PAPER 182, *supra* note 31, at 12. {ASIC Consultation Paper 182, above n 31, 12.}

[65] *Wingecarribee Shire Council v Lehman Bros. Austl. Ltd.* [2012] FCA 1028, ¶¶ 932–46 (Austl.) {*Wingecarribee Shire Council v Lehmann Brothers Australia Ltd (in Liq)* [2012] FCA 1028 at [932]–[946]}; *Bathurst Reg'l Council v Local Gov't Fin. Servs. Pty Ltd. (No. 5)* [2012] FCA 1200, ¶¶ 2278–84 (Austl.) {*Bathurst Regional Council v Local Government Financial Services. Pty Ltd (No 5)* [2012] FCA 1200}. These cases were decided subsequent to the written Article presented at the Symposium.

2008 financial crisis.[66] The advice was pursuant to contractual and non-contractual arrangements.[67] Although a fiduciary duty arises as an incident of a particular relationship and can be modified by contract, both cases establish that a financial adviser owes a fiduciary duty to those with whom it deals.[68] These decisions contrast with the decision concerning a rating agency in so far as it assigns a rating. In *Bathurst Regional Council v Local Government Financial Services Pty Ltd.*, the court held that when a rating agency assigns a rating, this does not of itself create a fiduciary relationship, and further, that a rating is an expert opinion, not advice.[69] In both cases, the financial advisors failed to sufficiently disclose conflicts of interest and the extent to which they would benefit from the transactions.[70]

III. BEST INTERESTS AND APPROPRIATE ADVICE

The FOFA legislation distinguishes between a duty in relation to the advice and the standard of the advice; the adviser must act in the best interests of the client and the advice must be appropriate to the client.[71] The relationship between the acts of the adviser and the standard of the advice is that the adviser meets the standard of appropriate advice by acting in the best

[66] *See Wingecarribee Shire Council*, [2012] FCA ¶¶ 30–695 {See *Wingecarribee Shire Council v Lehmann Brothers Australia Ltd (in Liq)* [2012] FCA 1028 per Rares J at [30]–[695]}; *Bathurst Reg'l Council*, [2012] FCA ¶¶ 1–24 {*Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200 per Jagot J at [1]–[24]}.

[67] *See Wingecarribee Shire Council*, [2012] FCA ¶¶ 30–695 {see *Wingecarribee Shire Council v Lehmann Brothers Australia Ltd (in Liq)* [2012] FCA 1028 per Rares J at [30]–[695]}; *Bathurst Reg'l Council*, [2012] FCA ¶¶ 1–24 {*Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200 per Jagot J at [1]–[24]}.

[68] *See Wingecarribee Shire Council*, [2012] FCA ¶¶ 729–30, 733 {see *Wingecarribee Shire Council v Lehmann Brothers Australia Ltd (in Liq)* [2012] FCA 1028 per Rares J at [729], [730], [733]}; *Bathurst Reg'l Council*, [2012] FCA ¶ 2314 {*Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200 at [2314]}.

[69] *Bathurst Reg'l Council*, [2012] FCA ¶¶ 2528, 2534, 2789–90. {*Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200 per Jagot J at [2528], [2534], [2789], [2790].}

[70] *Wingecarribee Shire Council*, [2012] FCA ¶¶ 939, 941 {*Wingecarribee Shire Council v Lehmann Brothers Australia Ltd (in Liq)* [2012] FCA 1028 at [939], [941]}; *Bathurst Reg'l Council*, [2012] FCA ¶ 50 {*Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200 at [50]}.

[71] *Corporations Act 2001* (Cth) ss 961B(1), 961G (Austl.). {*Corporations Act 2001* (Cth) ss 961B(1), 961G.}

interests of the client.[72] Thus, the standard of the advice is judged by reference to the acts of the adviser, not by the nature of the resulting advice. There is no obligation to provide advice that is "best" for the client. The new statutory obligation is different from a fiduciary duty as it operates in Australia and may fall short of the pre-existing obligation to provide appropriate advice.[73]

If there is a conflict of interest between the interests of the provider and the interests of the client, there is an obligation for the adviser to give priority to the interests of the client.[74] There is also an obligation to warn the client if the advice is based on information that is inadequate or incomplete.[75]

An adviser may fulfill the best interests duty and thus provide appropriate advice by completing all of the best interests steps prior to giving the advice.[76] The legislation does not indicate that this way is the only way to fulfill the best interests duty. It is possible to provide advice without having completed or having inadequately completed the best interests steps.[77] It is unclear how an adviser may satisfy the best interests duty in an alternate way.[78] The best interests steps themselves do not

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[72] *Id.* s 961G. {Ibid s 961G.}

[73] Andrew J. Serpell, *The Future of Financial Advice Reforms*, 30 COMPANY & SEC. L.J. 240, 251(2012) {A Serpell, 'The Future of Financial Advice Reforms' (2012) 30 *Company and Securities Law Journal* 240 at 251} suggests the significant difference is that a contravention of the now repealed section 945A entailed a criminal offense. Section 945A was repealed in *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth) sch 1 cl 6 (Austl.) {Section 945A was repealed in *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* Schedule 1 cl 6}.

[74] *Corporations Act 2001* (Cth) s 961J (Austl.). {*Corporations Act 2001* (Cth) s 961J.} This obligation is different from the Australian financial services license obligation which requires a licensee to have adequate arrangements in place to manage conflicts of interest. *Id.* s 912A(1)(aa). {Ibid s 912A(1)(aa).} This "statutory requirement is to be contrasted with the duty in equity of a fiduciary to eliminate or avoid conflicts." *See Australian Sec. & Invs. Comm'n v Citigroup Global Mkts. Austl. Pty Ltd.* [2007] FCA 963, ¶¶ 311, 441. {*Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Limited (ACN 113 114832) No 4* [2007] FCA 963 per Jacobson J at [311], see also [441]f.}

[75] *Corporations Act 2001* (Cth) s 961H (Austl.). {*Corporations Act 2001* (Cth) s 961H.}

[76] *Id.* s 961B(2). {Ibid s 961B(2).}

[77] *See id.* s 961B(1). {Ibid s 961B(1).}

[78] ASIC is yet to give any guidance on complying with the best interests duty without completing the steps in s 961B(2) in its Consultation Papers. Since this duty is a positive duty to act, the proscriptive no-conflict, no-profit approach may be insufficient. A court may look to the content of a fiduciary duty. For instance, in

positively require advice to be based on accurate and complete information.[79] The provider must undertake each of the steps to meet the best interests obligation via this route.[80] The standard in taking each step is tort-like. It references the existing reasonable expertise of the industry in making judgments about the best interest of the client.[81] If a provider with a reasonable level of expertise would take a step, then it is in the best interests of the client. This standard does not go directly to the advice given to the client; it goes to the judgments made by the adviser in advising the client.[82] It goes to process, not outcome.[83] The Explanatory Memorandum for FOFA states that these best interests steps are not envisaged as an "exhaustive and mechanical checklist,"[84] which is consistent with the inclusion of

Daly v. Sydney Stock Exchange, the duty was to furnish clients with all relevant knowledge concealing nothing relevant to making the investment decision. *Daly v. Sydney Stock Exchange* (1986) 160 CLR 371, 385 (Austl.). {*Daly v the Sydney Stock Exchange* (1986) 160 CLR 371 per Brennan J at [385]; [1986] HCA 25.} A court may also look at other statutory provisions which require acting in best interests. In *Australian Securities & Investments Commission v. Maxwell*, Justice Brereton said "a breach of the obligation to act bona fide in the interests of the company involves a consciousness that what is being done is not in the interests of the company, and deliberate conduct in disregard of that knowledge." *Australian Sec. & Invs. Comm'n v Maxwell* (2006) 59 ACSR 373, ¶ 107. {*Australian Securities & Investments Commission v Maxwell* [2006] NSWSC 1052 per Brereton J at [107].} These different approaches will need to be resolved.

[79] This situation is quite different from the obligation, in separate legislation, imposed on intermediaries, who are finance brokers, or "credit assistants," and provide suggestions about consumer credit products. *See National Consumer Credit Protection Act 2009* (Cth) s 8 (Austl.). {*National Consumer Credit Protection Act* (Cth) 2009.}

[80] *Corporations Act 2001* (Cth) s 961B(2) (Austl.). {*Corporations Act 2001* (Cth) s 961B(2).}

[81] *Id.* s 961E. {Ibid s 961E.}

[82] *Id.* s 961B(2)(f). {Ibid s 961B(f).}

[83] There is an untested assumption that "good processes will improve the quality of the advice that is provided." *See* Further FOFA Bill Revised Explanatory Memorandum, *supra* note 33, at 10. {See Further FOFA Bill Revised Explanatory Memorandum, above n 33, 10, [1.23].} In contrast, ASIC warns that advice should leave clients in a better position. *See* ASIC REGULATORY GUIDE 175, *supra* note 21, at 47 {ASIC Regulatory Guide 175, above n 21, 175.A27–28}; ASIC CONSULTATION PAPER 182, *supra* note 31, at 12 {ASIC Consultation Paper 182, above n 31}.

[84] *See* Further FOFA Bill Revised Explanatory Memorandum, *supra* note 33, at 10. {Further FOFA Bill Revised Explanatory Memorandum, above n 33, 10, [1.25].}

the last step requiring the adviser to take "any other step that . . . would reasonably be regarded as being in the best interests of the client."[85]

The provider should first identify the following: (1) the objectives, financial situation, and needs of the client[86]—but there is no obligation to go beyond the client's instructions or to verify the information; (2) the subject matter of the advice sought by the client—either explicitly or implicitly;[87] (3) the circumstances of the client that are relevant to the advice sought on that subject matter—that is, a filtering of the client objectives, financial situation, and needs.[88]

If it is reasonably apparent that information about the client's relevant circumstances is incomplete or inaccurate, the provider must make reasonable inquiries to obtain complete and accurate advice.[89] The legislation provides a standard akin to a tort duty of care to determine whether something is reasonably apparent.[90] There is no legislative indication of what reasonable

[85] *Corporations Act 2001* (Cth) s 961B(2)(g) (Austl.). {*Corporations Act 2001* (Cth) s 961B(2)(g).} The inclusion of this step means that the steps do not provide a "safe harbour" for advisers, although ASIC's draft guidance on this step suggests that ASIC only has limited expectations of what an adviser would need to do to satisfy this requirement. ASIC CONSULTATION PAPER 182, *supra* note 31, at 57–59 {ASIC Consultation Paper 182, above n 31}; ASIC REGULATORY GUIDE 175, *supra* note 21, at 69–86 {ASIC Regulatory Guide 175, above n 21,175.A110-A113}.

[86] *Corporations Act 2001* (Cth) s 961B(2)(a) (Austl.). {*Corporations Act 2001* (Cth) s 961B(2)(a).}

[87] *Id.* s 961B(2)(b)(i). {Ibid s 961B(2)(b)(i).}

[88] *Id.* s 961B(2)(ii). {Ibid s 961B(2)(b)(ii).} The Explanatory Memorandum says explicitly that this process is to accommodate limited or scaled advice. *See* Further FOFA Bill Revised Explanatory Memorandum, *supra* note 33, at 12. {Further FOFA Bill Revised Explanatory Memorandum, above n 33, 12, [1.35].}

[89] *Corporations Act 2001* (Cth) s 961B(2)(c) (Austl.). {*Corporations Act 2001* (Cth) s 961B(2)(c).}

[90] "Something is reasonably apparent if it would be apparent to a person with a reasonable level of expertise in the subject matter of the advice that has been sought by the client, were that person exercising care and objectively assessing the information given to the provider by the client." *Id.* s 961C. {*Corporations Act 2001* (Cth) s 961C.} This test is not dissimilar to the notion of peer professional opinion in the Civil Liability Act. *See Civil Liability Act 2002* (NSW) s 5O. {See *Civil Liability Act* (NSW) s 5 O.} The Explanatory Memorandum says that this test is an objective test based on the standards of the industry and the subject matter of the advice, which will vary according to the complexity of the advice. Further FOFA Bill Revised Explanatory Memorandum, *supra* note 33, at 12. {Further FOFA Bill Revised Explanatory Memorandum, above n 33, 12 [1.37].}

inquiries might entail. The obligation is the making of the inquiry. There is no obligation that the information actually be complete and accurate.[91]

Having done this, the provider must then ask a question of himself or herself: Does he or she have the expertise to give advice on the subject matter concerned? If not, the adviser must decline to give advice.[92] There is no specific provision dealing with the possibility that a provider may overestimate his or her expertise.[93] Next, if it would be reasonable to consider recommending a financial product to the client on the subject matter of the advice sought by the client, the provider must conduct an investigation of possible financial products,[94] assess the information gleaned by this investigation,[95] and base all judgments in advising the client on the circumstances of the client.[96] The matter at issue here is the nature of the investigation. The investigation is into products for those filtered, relevant circumstances identified by the provider, but it does not require an investigation into "every financial product available."[97] However, if the client asks the provider to consider a specified financial product, then this product must be included in the investigation.[98] Finally, in actually advising the client, the provider must base all judgments on the client's relevant circumstances.[99]

There is a carve-out from the best interests steps for two types of products. If the subject matter of the advice is a basic banking product or a general insurance product, the providers do not have to assess their own competence, investigate products to

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[91] Further FOFA Bill Revised Explanatory Memorandum, *supra* note 33, at 12. {Further FOFA Bill Revised Explanatory Memorandum, above n 33, 12, [1.36].}

[92] *Corporations Act 2001* (Cth) s 961B(2)(d) (Austl.). {*Corporations Act 2001* (Cth) s 961B (2)(d).}

[93] Australian financial services licensees must maintain their competence to provide the service for which they are licensed and ensure that their representatives are adequately trained and competent. *Id.* s 912A(1)(e), (f). {Ibid s 912A (1)(e)(f).}

[94] *Id.* s 961B(2)(e)(i). {Ibid s 961B (2)(e)(i).}

[95] *Id.* s 961B(2)(e)(ii). {Ibid s 961B (2)(e)(ii).}

[96] *Id.* s 961B(2)(f). {Ibid s 961B (2)(f).}

[97] They must conduct an investigation into 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." *Id.* ss 961B(2)(e)(i), 961D(1). {Ibid ss 961B(2)(e)(i); 961D(1).}

[98] *See id.* s 961D(2) {Ibid s 961D(2)} (stating no indication of how specific a specified financial product must be).

[99] *Id.* s 961B(2)(f). {Ibid s 961B(2)(f).}

achieve the aims of the client, base judgments on the client's circumstances, or take other reasonable steps. They, however, must still take the first three steps, which include identifying the client's objectives, identifying the subject matter of the advice, and if necessary, making inquiries to obtain further information.[100]

The best interests steps have been criticized for promoting perfunctory compliance and possibly leading to outcomes that would fail a common law test of the duty of care of a financial adviser.[101] ASIC itself describes the best interests steps as a "safe harbour."[102]

If it is clear that the information on which advice is based is incomplete or inaccurate, the provider can still give advice but must warn the client.[103] This warning must be given at the same time as the advice is given, must state that the advice is incomplete or inaccurate in relation to the relevant circumstances of the client and must also state that before acting on the advice, the client should consider whether it is appropriate.[104] This warning suggests that, notwithstanding the obligation to give only appropriate advice,[105] clients still have to ask themselves if the advice is appropriate, because in some circumstances it may not be. Some providers may make inquiries and obtain information requested, but as a failsafe they may still give a warning.

This provision is different from the earlier obligation to warn if advice was based on incomplete or inaccurate information. The new provision rests on it being "reasonably apparent" that the

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[100] *Id.* s 961B(2)–(4). {Ibid ss 961B(2)–(4).}

[101] *See* Craddock, *supra* note 8, at 235. {Craddock, above n 8, 235.} The question here is not whether a duty of care exists but the scope of that duty. Does it require an adviser to seek out investment opportunities or simply draw the client's attention to opportunities of which the adviser is aware? This distinction is discussed in *Aequitas Ltd. v. Sparad No. 100 Ltd.*, in which the latter was preferred. *Aequitas Ltd. v. Sparad No. 100 Ltd.* [2001] NSWSC 14, ¶ 82 (Austl.). {*Aequitas v Aefc* [2001] NSWSC 14 per Austin J at [82].} It is important to recognize, however, that the best interests steps do override common law duties where they apply. *See* ASIC CONSULTATION PAPER 182, *supra* note 31, at 12–13. {See ASIC Consultation Paper 182, above n 31, [30].}

[102] ASIC CONSULTATION PAPER 182, *supra* note 31, at 10. {ASIC Consultation Paper 182, above n 31, 17.}

[103] *Corporations Act 2001* (Cth) s 961H (Austl.). {*Corporations Act 2001* (Cth) s 961H.}

[104] *See id.* s 961H(1), (2). {Ibid ss 961H(2), 961H(10)(a)(b).}

[105] *See id.* s 961G. {Ibid s 961G.}

information is incomplete or inaccurate. Under the old provision, the obligation arose if the providing entity knew the information was incomplete or inaccurate, or was reckless as to whether it was incomplete or inaccurate.[106]

A. *Priority to the Client*

The obligation to give priority to the interests of the client complements the obligation of the provider to act in the best interests of the client, which may involve the process of the best interests steps at the level of care of a person with a reasonable level of expertise.[107] Unlike the licensee requirement to manage conflicts, this requirement falls on the individual advice provider. The obligation arises only if the provider knows or should know there is a conflict between the interests of the client and others.[108] The legislation has no definition of conflict of interest and the examples in the Explanatory Memorandum concern payments.[109]

The rules target those beyond the adviser whose interests may be in conflict with the client. They are specifically listed and include the provider and his or her associates, financial services licensee and associates, and authorized representatives of the licensee and associates.[110] Again, there is a carve-out for basic banking products and general insurance products.[111]

A provider may still charge for services at a market rate and in some circumstances may still accept a commission.[112] ASIC proposes that to comply with the priority rule, advisers should consider what amounts to a "no conflicts" approach and ask "what an advice provider without a conflict of interest would do."[113]

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[106] *Id.* s 945B (repealed 2012). {Ibid s 945B (repealed).}

[107] *See id.* s 961J. {Ibid s 961J.}

[108] *Id.* s 961J(1). {Ibid s 961J(1).}

[109] *See* Further FOFA Bill Revised Explanatory Memorandum, *supra* note 33, at 19. {Further FOFA Bill Revised Explanatory Memorandum, above n 33, 19, [1.67]–[1.68].}

[110] *Corporations Act 2001* (Cth) s 961J(1)(a)–(f) (Austl.). {*Corporations Act 2001* (Cth) ss 961J(1)(a)–(f).}

[111] *Id.* s 961J(2), (3). {Ibid ss 961J(2)–961J(3).}

[112] *See* Further FOFA Bill Revised Explanatory Memorandum, *supra* note 33, at 19. {Further FOFA Bill Revised Explanatory Memorandum, above n 33, 19, [1.67]–[1.68].}

[113] *See* ASIC CONSULTATION PAPER 182, *supra* note 31, at 21. {ASIC Consultation Paper 182, above n 31, 21.}

B. Limited or Scaleable Advice

The scope of the financial adviser's obligation to the client will depend on what the client wants and the arrangements between the client and the adviser. Scaleable advice is personal advice that is limited in scope.[114] ASIC reports that more clients want advice on a case-by-case basis and are not looking for comprehensive advice; financial planners fear that if they give such piecemeal advice they may fall afoul of the rule to act in the best interests of the client.[115] The Explanatory Memorandum clearly says that step two, identifying the subject matter of the advice sought by the client, is to facilitate both scaled, limited, targeted, and specific advice on a single matter as well as comprehensive, holistic advice.[116] But it warns: "The scaling of advice by the provider must itself be in the client's best interests, especially since the client's instructions may at times be unclear or not appropriate for his or her circumstances."[117]

In the situation where a client is unable to easily identify the subject matter of the advice he or she wants, the Explanatory Memorandum says advisers should discuss this subject matter with the client. This conversation should be about what subject matter for advice would be in the client's best interests, also taking into account how much the client wishes to pay for the advice and the client's overall circumstances.[118] Again, the Explanatory Memorandum warns that the adviser cannot escape these difficulties simply by stating in the contract that the subject matter is as requested by the client and therefore is in the best interests of the client.[119] ASIC warns that all advice, scaled or otherwise, should leave clients in a better position and emphasizes the importance of the judgment of the adviser,

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[114] AUSTRALIAN SEC. & INVS. COMM'N, CONSULATION PAPER 183, GIVING INFORMATION, GENERAL ADVICE AND SCALED ADVICE 7 (2012) [hereinafter ASIC CONSULTATION PAPER 183]. {Australian Securities and Investments Commission, *Giving Information, General Advice and Scaled Advice*, Consultation Paper 183, August 2012 ('ASIC Consultation Paper 183') 7.}

[115] *Id.* at 8 {Ibid 8}; *see* PARLIAMENTARY JOINT COMMITTEE INQUIRY AND REPORT, *supra* note 33, at 55 {Parliamentary Joint Committee Inquiry and Report, above n 33, 55}.

[116] *See* Further FOFA Bill Revised Explanatory Memorandum, *supra* note 33, at 12. {Further FOFA Bill Revised Explanatory Memorandum, above n 33, 12, [1.34].}

[117] *Id.* {Ibid.}

[118] *Id.* at 11–12. {Ibid 11, [1.33].}

[119] *Id.* at 11. {Ibid.}

including, in some circumstances, declining to give advice.[120] ASIC admonishes that important issues, such as debt on retirement or insurance attached to superannuation, should not be omitted because they are too difficult to resolve.[121] The interplay among elucidating the subject matter of the advice, the relevant circumstances of the client, and the best interests of the client does not seem to facilitate the scaling of advice that ASIC reports clients want and instead may challenge some advisers.

C. Falling Short of a Fiduciary Duty

One commentator's main objections to the legislation are "legal incoherence" and its capacity to hinder the development and application of both common law and fiduciary law to financial advisers.[122] Craddock believes that the best interests obligation adds little to the existing obligation to provide appropriate advice; there is a clear intention to create a statutory fiduciary duty which has miscarried; and the steps to satisfy the best interests requirement are probably less than required to satisfy the common law duty of care expected of a financial adviser.[123] He also argues that the persistence of conflicts is not overcome by the rule to prioritize the client in case of conflicts.[124] It is possible that the statutory best interests, appropriate advice, and client priority duties may alter some product recommendations. The jury is out on whether, by themselves, these duties will enhance the quality of advice.

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[120] *See* ASIC CONSULTATION PAPER 183, *supra* note 114, at 27, 29, 31. {ASIC Consultation Paper 183, above n 114, 27, 29, 31.} Judgment is important as the legislation also provides for the possibility of advice via a computer program. *See* PARLIAMENTARY JOINT COMMITTEE INQUIRY AND REPORT, *supra* note 33, at 57. {See discussion in Parliamentary Joint Committee Inquiry and Report, above n 33, 57.}

[121] *See* ASIC CONSULTATION PAPER 183, *supra* note 114, at 31. {ASIC Consultation Paper 183, above n 114, 31.}

[122] Craddock, *supra* note 8, at 236. {Craddock, above n 8, 236f.}

[123] *Id.* at 234–35. {Ibid 234–5.} For a further discussion of the best interests duty as a duty of care and not a fiduciary duty, see PARLIAMENTARY JOINT COMMITTEE INQUIRY AND REPORT, *supra* note 33, at 47 {see Parliamentary Joint Committee Inquiry and Report, above n 33, 47}.

[124] Craddock, *supra* note 8, at 236 {Craddock, above n 8, 236} (contrasting the statutory duty with the fiduciary no conflicts rule). Of course, the difference is that the fiduciary duty can be managed through informed consent which is not possible under the statutory duty.

IV. CONFLICTED REMUNERATION

Of all the FOFA changes, the ban on conflicted remuneration arguably has the biggest impact on the financial services sector in Australia. The introduction of the best interests duty and related provisions is a significant step in the process of raising professional standards for financial advisers, but most advisers and licensees believe that they are currently acting in their client's best interests and regard this change as more iterative than revolutionary. The opt-in and fee disclosure elements of FOFA have certainly been the most controversial changes and will have significant implications for adviser-client relations. However, these changes will not have as large an impact on relationships between industry participants. By contrast, the conflicted remuneration prohibitions are leading to a complete transformation of the commercial relationships between advisers and licensees, licensees and issuers, and platforms and fund managers. Licensees are struggling to develop compliant models of remuneration, which effectively align adviser and licensee interests to incentivize adviser conduct in relation to existing and new clients.

This impact on commercial relationships differentiates FOFA from other major reforms in the financial services sector in the past, including the introduction of the financial services licensing and disclosure regime from 2001 to 2003, the implantation of upgraded anti-money laundering and counter-terrorism financing legislation from 2006 to 2008, and the introduction of consumer credit licensing and suitability obligations in 2009. These changes imposed significant compliance burdens on the industry. However, the impact mainly affected back office compliance arrangements and retail disclosure. Unlike FOFA, they did not require significant adjustment of remuneration arrangements or business models.

There are a number of key elements to the ban on conflicted remuneration. First, the ban applies to licensees and also to advisers directly when *accepting* remuneration. Licensees must take reasonable steps to ensure that their representatives do not accept conflicted remuneration.[125] Second, it also applies to employers of advisers and product issuers *paying*

[125] *Corporations Act 2001* (Cth) ss 963E, 963F (Austl.). {*Corporations Act 2001* (Cth) ss 963E, 963F.}

remuneration.[126] Third, there is a general ban on remuneration which could reasonably be expected to influence retail advice and a presumption that volume-based payments will influence advice.[127] Fourth, the ban applies to both monetary and non-monetary benefits.[128] Fifth, there are certain exceptions, in particular for insurance and banking products and for certain types of "soft dollar" benefits.[129] Sixth, there are specific bans on platform operators accepting shelf-space fee payments from fund managers and charging asset-based fees on borrowed amounts.[130] Seventh, grandfathering of existing arrangements is permitted, in part due to constitutional concerns about the ability to apply the ban to such arrangements.[131] Eigth, anti-avoidance applies—discussed further below.[132] Finally, apart from the shelf-space fee ban, the bans do not apply to the wholesale market.[133]

A. *Background to the Ban*

The ban on conflicted remuneration originated with concerns regarding conflicted advice models, in particular the Storm Financial model, which relied on one-size-fits-all recommendations for clients to borrow funds to invest in market-linked investments.[134] Concerns were also expressed regarding the possible role of commissions in the failure of Opes Prime

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[126] *Id.* ss 963G, 963H. {Ibid ss 963G, 963H.}

[127] *Id.* ss 963A, 963J. {Ibid ss 963A, 963J.}

[128] *Id.* s 963A. {Ibid s 963A.}

[129] *Id.* ss 963B–963D {Ibid ss 963B–963D}; *Draft Corporations Amendment Regulation 2012* (Cth) regs 7.7A.4.12–.14 (Austl.) {Draft Corporations Regulations 7.7A.4.12–7.7A.4.14}.

[130] *See Corporations Act 2001* (Cth) pt 7.7A, div 5 (Austl.). {*Corporations Act 2001* (Cth) Part 7.7A, Div 5.}

[131] *Id.* ss 1528–1531 {Ibid ss 1528–1531}; *Draft Corporations Amendment Regulation 2012* (Cth) reg 7.7A.4.16 (Austl.) {Draft Corporations Regulation 7.7A.4.16}.

[132] *Corporations Act 2001* (Cth) s 965 (Austl.). {*Corporations Act 2001* (Cth) s 965.}

[133] *Id.* ss 963A, 964B. {*Corporations Act 2001* (Cth) ss 963A, 964B.} Technically, the ban on shelf-space fees does not appear to be restricted to the wholesale market, although it relies on a definition only used in a retail disclosure context.

[134] The model relied on rising markets and assumed that this strategy would keep working and was therefore appropriate for all clients whatever their circumstances. RIPOLL REPORT, *supra* note 7, at 27–30. {Ripoll Report, above n 7, [3.33]–[3.45], 27–30.} There was also some evidence of inappropriately high property valuations to support larger loans. *Id.* at 35–36. {Ripoll Report, above n 7, [3.66]–[3.69], 35–6.} The outcome for some clients was not only loss of investments, but loss of assets which had been mortgaged to borrow in order to invest.

representatives to disclose the higher risk nature of its securities lending arrangements.[135] One of the terms of reference for the resulting Ripoll inquiry was to investigate: "[T]he role played by commission arrangements relating to product sales and advice, including the potential for conflicts of interest, the need for appropriate disclosure, and remuneration models for financial advisers."[136]

The committee concluded that disclosure had not been effective in managing conflicts of interest[137] and made recommendations canvassing banning, which were the forerunner of the FOFA bans on conflicted remuneration:[138]

> 6.56 The committee received considerable evidence suggesting that the most effective way to improve the quality of financial advice for consumers is to remove conflicts of interest altogether by banning commissions and other conflicted remunerative practices. The regulation of remuneration practices was consistently raised during the inquiry.[139]
>
> Recommendation 4
>
> 6.101 The committee recommends that government consult with and support industry in developing the most appropriate mechanism by which to cease payments from financial product manufacturers to financial advisers.[140]

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[135] *Id.* at 66. {Ibid [4.70]–[4.71], 66.}

[136] *Id.* at vii. {Ibid vii.}

[137] *Id.* at 81–85, 87. {Ibid [5.53]–[5.68], 81–5; [5.74], 87.}

[138] Other measures were already being taken, including the regulation of margin lending as a financial product, making it subject to the financial services licensing and disclosure regime and the introduction of consumer credit licensing. Additional measures included the requirement to give clients notice of margin calls and the obligation on lenders and intermediaries to ensure that credit is appropriate for the client. *See Corporations Act 2001* (Cth) ss 985EA–985K (Austl.) {*Corporations Act 2001* (Cth) Part 7.8, Div 4A, Subdiv A}; *National Consumer Credit Protection Act 2009* (Cth) ss 115–120, 123–124, 128–133 (Austl.) {*National Consumer Credit Protection Act 2009* (Cth) Part 3-1, Div 4, Div 6; Part 3-2, Div 3, Div 4}.

[139] RIPOLL REPORT, *supra* note 7, at 116. {Ripoll Report, above n 7, 116.}

[140] *Id.* at 127. {Ibid 127.} The reference to consulting with industry recognized that the then Investment and Financial Services Association ("IFSA")—now renamed the Financial Services Council ("FSC")—had already developed an industry standard to ban superannuation commissions by July 1, 2012. INV. & FIN. SERVS. ASS'N LTD., IFSA'S SUPERANNUATION MEMBER CHARTER: A NEW COMMITMENT TO SUPERANNUATION MEMBERS (2009), *available at* http://riskinfo.com.au/news/files/2009/11/091118-ifsa-superannuation-member-charter_final.pdf. {IFSA's Superannuation Member Charter: A New Commitment to Superannuation Members released on 17 November 2009.}

B. *Ban on Conflicted Remuneration*

The Commonwealth government's response was to announce a "prospective ban on conflicted remuneration structures including commissions and volume based payments."[141] This ban is formulated in the legislative definition of "conflicted remuneration":

> 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.[142]

The legislation does not expressly ban commissions. The ban depends on this influence test; the circumstances in which a benefit "could reasonably be expected to influence" advice are critical.[143]

There is a presumption that a benefit is conflicted remuneration if access to or the value of the benefit is wholly or partly dependent on the value or number of financial products recommended to or acquired by a client—that is, volume-based remuneration.[144] However, some volume-based benefit structures might not be inherently conflicted. The Explanatory

[141] Press Release, Chris Bowen, Minister for Fin. Servs., Superannuation & Corporate Law, The Treasury of the Commonwealth of Austl., No. 036 Overhaul of Financial Advice, (Apr. 26, 2010), http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/036.htm&pageID=003&min=ceba&Year=&DocType. {Chris Bowen, 'Overhaul of Financial Advice' (Media Release No. 036, 26 April 2010) <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/036.htm&pageID=003&min=ceba&Year=&DocType>.}

[142] *Corporations Act 2001* (Cth) s 963A (Austl.). {*Corporations Act 2001* (Cth) s 963A.}

[143] *Id.* {Ibid.}

[144] *Id.* s 963L. {Ibid s 963L.}

Memorandum recognizes this and that those involved in such an arrangement must disprove the presumption and demonstrate that the benefits are not conflicted.[145]

Whether a particular remuneration structure is permitted seems to depend on the circumstances at the time the benefit is given or received. Factors potentially relevant to this consideration include the following: (1) the proportion of the benefit to total remuneration; (2) the level of involvement of the recipient of the benefit in giving the advice; and (3) the nature of the link between the benefit and the value or number of financial products recommended or acquired.

The Explanatory Memorandum states the legislation provides flexibility to maintain broadly based performance-based remuneration arrangements without compromising advice provided to retail clients. It provides the following example:

> [I]f the benefit was based on the total profitability of the licensee, it was on a small percentage of the total remuneration of the recipient, [and the recipient was not involved in providing financial advice to retail clients] it would be less likely of being able to influence the recommendations or advice provided to retail clients.[146]

The test for conflicted remuneration based on what could reasonably be expected to influence advice is an objective test.[147] Case law indicates that "reasonably be expected" is something "more than a possibility" but must have "real and substantial grounds" for expectation of occurrence.[148] It does not, however,

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[145] Further FOFA Bill Revised Explanatory Memorandum, *supra* note 33, at 27–29. {Further FOFA Bill Revised Explanatory Memorandum, above n 33, [2.18]–[2.20].}

[146] *Id.* at 28–29. {Further FOFA Bill Revised Explanatory Memorandum, Example 2.1, [2.19].}

[147] *Attorney-General's Dep't v Cockcroft* (1986) 10 FCR 180, 193 (Austl.). {*Attorney-General's Department & Australian Iron and Steel Pty Ltd v Cockcroft* (1986) 10 FCR 180 at 193.}

[148] *Id.* {Ibid.}

need to be "probable."[149] This test is consistent with the change from a test of "might influence" the advice, which was proposed in the Exposure Draft of the Bill.[150]

The context of the advice may indicate that remuneration was not reasonably expected to influence the advice and should not be "conflicted remuneration." This context might involve consideration of the level and nature of controls and other measures designed to ensure that advice is not influenced by remuneration, which could include the following.

C. Consequences for the Adviser

The consequences of giving conflicted advice may reduce the likelihood that conflicted advice will be given. Consequences could range from a poor performance review, which affects the level of discretionary bonus; some form of penalty; naming and shaming; termination of employment; seeking to have advisers banned by the regulator; or other disciplinary action. Of course, penalties raise contractual law and, where relevant, employment law issues regarding enforceability.

1. Preventative Controls

The nature and effectiveness of the controls to prevent conflicted advice from being given will also be relevant. For example, if advice is reviewed before it is provided to the client by someone who does not receive conflicted remuneration, then the otherwise conflicted remuneration paid to the "adviser" may

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[149] In the context of freedom of information applications, it has been held that the phrase, "could reasonably be expected" to destroy commercial value or to prejudice future disclosure of information, should be given its ordinary meaning. This meaning is something that is reasonable and not "irrational, absurd or ridiculous." Further, "it is undesirable to consider the operation of the provision in terms of probabilities or possibilities." *Id.* at 190 {Ibid 190}; *see also Apache Nw. Pty. Ltd. v Dep't of Mines & Petroleum* [2012] WASCA 167, ¶ 60. (Austl.) {*Apache Northwest Pty Ltd v Dept of Mines and Petroleum* (No 2) [2011] WASC 283}; *Searle Austl. Pty Ltd. v Pub. Interest Advocacy Ctr.* (1992) 36 FCR 111, 123 (Austl.) {*Searle Australia Pty Ltd v Public Interest Advocacy Centre* [1992] FCA 241; (1992) 36 FCR 111, 123}; *News Corp. v Nat'l Cos. & Sec. Comm'n* (1984) 5 FCR 88, 101 (Austl.) {*News Corporation Ltd v National Companies and Securities Commission* (1984) 5 FCR 88 per Woodward J at 101} ("A reasonable expectation of an event requires more than a possibility, risk or chance of the event occurring.").

[150] Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (Cth) s 963(1) (Austl.). {Exposure Draft, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, 28 September 2011, clause 963(1).}

be unlikely to influence the advice actually given to the client. This review may not be practical for some organizations or certain types of advice—for example, quick telephone-based advice.

2. Effectiveness of Controls

A compliance regime with serious consequences for conflicted advice will only be effective if it is actually implemented and is seen to be implemented.

3. Cultural Factors

The ethical environment of the organization is also likely to be relevant. An effective compliance regime requires an organizational culture which supports and fosters compliance. It must be actively and visibly supported at all levels of the organization and could be undermined in a particular area by the attitude of staff or management in that area.

None of these measures are likely to be enough on their own to establish that remuneration could not reasonably be expected to influence advice. A licensee would presumably also need to be satisfied that its controls are stronger than the average level of controls currently prevalent in the Australian financial services industry. ASIC's position on the ability of licensees to continue to pay remuneration linked to conflicted factors, such as funds under advice, by implementing appropriate control measures, is currently unknown and will be an important consideration for licensees.

The ban applies both to those accepting remuneration—licensees and their representatives—and to product issuers and employers of representatives paying remuneration.[151] The ban on

[151] *See Corporations Act 2001* (Cth) ss 963E, 963K (Austl.). {*Corporations Act 2001* (Cth) Part 7.7A, Division 4, Subdivision C.} The ban is a civil penalty provision for licensees and authorized representatives—who are generally not employees—but not for employed representatives. *Id.* ss 963E, 963G, 963H. {Ibid ss 963E, 963G–963H.} Employees are only subject to the ban where the remuneration is not received from their employer on the basis that "in the majority of cases it is the employer, rather than the employee, that sets the terms and conditions of an employment contract [and is] in control of remuneration payments." Further FOFA Bill Revised Explanatory Memorandum, *supra* note 33, at 36. {Further FOFA Bill Revised Explanatory Memorandum, above n 33, 36, [2.57].} Employees who do accept conflicted remuneration from someone other than their employer may be subject to a banning order. *Corporations Act 2001* (Cth) s 963H (Austl.). {Note to *Corporations Act 2001* (Cth) s 963H.} Licensees must in any case take reasonable

product issuers paying conflicted remuneration may be challenging to implement given the definition of conflicted remuneration and the presumption that volume based benefits are conflicted. As discussed above, it is a question of fact whether particular remuneration is conflicted in the hands of the recipient.[152] It is therefore difficult for an issuer to assess this fact. It may require issuers to undertake due diligence of unrelated licensees to ensure payments received are not conflicted—it is certainly likely that appropriate assurances will be required.

D. Exemptions from the Ban

Exemptions from the ban on conflicted remuneration include the following: (1) client "given" benefits; (2) most simple banking product advice; (3) most insurance-related advice, subject to some important exceptions; (4) execution only benefits; (5) stamping fees and brokerage; (6) "soft dollar" benefits worth less than 300 AUD which are not given frequently or regularly; (7) education and training; and (8) information technology software or support relating to products provided by the benefit provider. Each of these exemptions gives rise to interesting issues.

1. Client "Given" Benefits

There is an exemption to the ban on conflicted remuneration where: "[T]he benefit is given to the licensee or representative by a retail client in relation to: (i) the issue or sale of a financial product by the licensee or representative to the client; or (ii) financial product advice given by the licensee or representative to the client."[153]

"Give" or "given" is not defined. However, doing an act, such as giving a benefit, includes causing or authorizing the act or thing to be done.[154] Consequently, this exemption for benefits

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steps to ensure that their representatives do not accept conflicted remuneration. *Id.* s 963F. {*Corporations Act 2001* (Cth) s 963F.}

[152] *Corporations Act 2001* (Cth) s 963L (Austl.) {*Corporations Act 2001* (Cth) s 963L}; *see supra* notes 140–42 and accompanying text.

[153] *Corporations Act 2001* (Cth) ss 963B(1)(d), 963C(e) (Austl.). {*Corporations Act 2001* (Cth) ss 963B(1)(d), 963C(e).}

[154] *Id.* s 52. {Ibid s 52.} While there is no case law on this provision, consideration has been given to "authorise." In *Ex parte Johnson*, Chief Justice Jordan said, "The word 'authorize,' according to its natural meaning, signifies the conferring upon a person of a right to do something which, apart from the

given by a client can extend to advisers where the client directly gives the benefit to the adviser—for example, by paying advice fees to the adviser—or causes or authorizes the benefit to be given to the adviser.

The Explanatory Memorandum supports the conclusion that the benefit does not need to be given directly by the client. It states:

> '[F]ee for service' arrangements—where the client is the person paying the adviser—are not conflicted remuneration (even where the client pays a volume-based fee). The provision is intended to exclude from the definition of conflicted remuneration any fee for service paid by the retail client, whether the benefit is given directly by the retail client or is given by another party at the direction, or with the clear consent, of the retail client.[155]

This exemption seems to indicate that Parliament did not intend to infringe on a client's ability to agree to any fee structure he or she might see fit. However, advisers and licensees are subject to other duties which will affect their ability to propose or agree to particular remuneration arrangements.[156]

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authorization, he does not possess." *Ex parte Johnson* (1946) 47 SR (NSW) 16, 18 (Austl.). {*Ex parte Johnson; re MacMillan* (1946) 47 SR (NSW) 16 per Jordan CJ at 18.} "Authorise" has also been considered at length in the intellectual property context and has been given a broad meaning. It has been held to mean to sanction, approve, or countenance an infringing act. *Univ. of N.S.W. v Moorhouse* (1975) 133 CLR 1, 12 (Austl.) {*University of New South Wales v Moorhouse* (1975) 133 CLR 1; 6 ALR 193)} (finding authorise traditionally had the meaning of "sanction, approve, countenance"); *Corp. of Adelaide v Australasian Performing Right Ass'n* (1928) 40 CLR 481 (Austl.) {*Corporation of the City of Adelaide v Australasian Performing Right Assn Ltd* (1928) 40 CLR 481; [1928] ALR 127)} (finding authorise means "to permit"). The courts have also held that authorization generally requires some power to prevent the act, and some actual or constructive knowledge of the act; however, express sanction or permission is not required. *Roadshow Films Pty Ltd. v iiNet Ltd.* (2010) 263 ALR 215, ¶ 374–76 (Austl.) {*Roadshow Films Pty Ltd v iiNet Ltd* (No 3) (2010) 263 ALR 215; 83 IPR 430; [2010] FCA 24}; *Universal Music Austl. Pty Ltd. v Sharman License Holdings Ltd.* (2005) 220 ALR 1, ¶ 365–66 (Austl.) {*Universal Music Australia Pty Ltd v Sharman License Holdings Ltd* (2005) 220 ALR 1; 65 IPR 289; [2005] FCA 1242}.

[155] *See* Further FOFA Bill Revised Explanatory Memorandum, *supra* note 33, at 30. {See Further FOFA Bill Revised Explanatory Memorandum, above n 33, 30.}

[156] Such duties may include the following: (1) the duty to act in the best interests of the client, *Corporations Act 2001* (Cth) s 961B (Austl.) {*Corporations Act 2001* (Cth) 961B}; (2) the duty to give priority to the client's interests, *id.* s 961J {*Corporations Act 2001* (Cth) s 961J}; (3) the duty to manage conflicts of interest, *id.* s 912A(1)(aa) {*Corporations Act 2001* (Cth) s 912A(1)(aa)}; and (4) the duty to provide

The exemption does mean that advisers can still arrange for clients to pay fees by deduction from their account without infringing the ban. This fact is important as "dial up" adviser service fee arrangements provided by product issuers could otherwise be regarded as prohibited "commission" payments.

There may be difficulties in establishing the client-given-benefit exemption in other circumstances. It is a significant problem for licensees to remunerate advisers without infringing the ban on conflicted remuneration. Traditionally, advisers have received direct or indirect incentives based on the revenue received by licensees from the adviser's clients. This receipt does not cause any particular difficulty where client fees are based on hourly rates or flat fees for particular services which are not linked to types of financial products.

However, many licensees and advisers charge clients on the basis of funds under advice that is volume-based remuneration. In recent times, this formulation is typically product neutral but it may still incentivize an adviser to recommend that a client invest funds in investments which count toward funds under advice, as opposed to paying off debt or investing in other types of investment.[157] While it is possible to develop proxies for funds under management that should not be conflicted remuneration,[158] there are concerns in the industry that such measures mean that adviser interests are not fully aligned with business success. There is an irony in the balance between client "given" benefits and volume-based benefits. It is possible for the client to agree to pay licensees based on funds under advice—which would otherwise be conflicted remuneration—but licensees may not be able to pay a share of that remuneration directly to the adviser who brought in these fees. One possibility may be to rely on the client "given" benefit exemption. This reliance would involve obtaining client agreement for both the fee paid to the licensee and for a proportion of the fee to be paid to the adviser. While

financial services efficiently, honestly, and fairly, *id.* s 912A(1)(a) {*Corporations Act 2001* (Cth) s 912A(1)(a)}.

[157] For example, funds under advice typically include managed funds, superannuation, and shares—where the adviser is authorized to advise on shares. They would not normally include real estate or less traditional forms of investment such as artwork. It may not include certain bank account balances.

[158] An example of such a proxy may be the client's net wealth. This would be a proxy for funds under advice as higher net worth clients are likely to have more investments, and therefore more funds under advice.

such an arrangement may appear unusual, it does seem consistent with the purpose of the exemption to give the client control over remuneration. And where a client does obtain such control, remuneration is thus being designated as not conflicted. This model does have some challenges.

Simply disclosing the form of remuneration to the client will not be enough. It is clear that FOFA is intended to move beyond a disclosure model to cure conflicts and is intended to ensure that conflicted remuneration is permitted only where the client gives that benefit, subject to other exemptions.

On the other hand, there does not seem to be any need for the arrangement to be negotiable as such. It should be possible for licensees and advisers to set the terms on which they will provide services to clients. If the terms are not negotiable, the client's choice is whether to acquire the services on the terms proposed.

It is easier to conclude that a client has directed that a share of the licensee's fee be paid to the client's adviser where the share is directly specified by the client. It may be harder to establish a relevant "direction or clear consent" where the model is more complex and the share of remuneration depends on other factors, such as the level of remuneration generated by the adviser from all clients or the compliance or quality of advice given.

As the focus of the exemption is on the individual client, it is likely that the test is a subjective one for each particular client. If so, the adviser and the licensee would need to be satisfied on an individual basis that the client has "given" the benefit.

2. Banking and Insurance Products

A number of different exemptions apply to banking and insurance products which are mainly, but not entirely, carved out of the prohibition on conflicted remuneration. They apply for a variety of reasons. However, the government's fear that such exemptions will be misused has led to complex exemptions which make it difficult for the industry to rely on them.

It is important firstly to recognize that the ban will not apply to all financial products as that term would ordinarily be understood. The financial services regime in Chapter 7 of the Australian Corporations Act only applies to certain kinds of financial products and services, and in particular does not apply to credit products, including home loans, personal loans, and credit and charge cards.[159]

The FOFA Act provides the following product related exemptions: (1) benefits given solely in relation to general insurance;[160] (2) monetary benefits given solely in relation to life insurance, other than certain forms of life insurance available through superannuation;[161] (3) benefits given to banking representatives solely in relation to basic banking products.[162]

These limitations appear designed to ensure they cannot be taken advantage of to circumvent the general prohibition. This approach is not particularly logical given the anti-avoidance measure which has also been included in the regime, as discussed below. It also means the exemptions are viewed as impractical in many situations as most advisers advise on a range of products.

The exemptions are cast very narrowly and it appears they cannot be combined. This narrow approach to the exemptions creates difficulties where advice is given on a number of topics or where joint products are issued.[163] The government responded to

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[159] "Financial product" and "financial service" are defined in divisions three and four of the Corporations Act. *Corporations Act 2001* (Cth) ss 763A, 766A (Austl.). {*Corporations Act 2001* (Cth) ss 763A, 766A.} Credit facilities are excluded. *Id.* s 765A(1)(h) {Ibid s 765A(1)(h)}; *Corporations Regulations 2001* (Cth) reg 7.1.06 (Austl.) {Corporations Regulation 7.1.06}.

[160] *Corporations Act 2001* (Cth) s 963B(1)(a) (Austl.). {*Corporations Act 2001* (Cth) s 963B(1)(a).}

[161] *Id.* s 963B(1)(b). {Ibid s 963B(1)(b).} The exclusion does not apply to non-monetary benefits, for which there is no explanation. However, the existing FSC/FPA Industry Code of Practice on Alternative Forms of Remuneration in the Wealth Management Industry applied to life insurance, so presumably the government did not want to water down existing restrictions. *See* FIN. SERVS. COUNCIL & FIN. PLANNING ASS'N, FSC/FPA INDUSTRY CODE OF PRACTICE ON ALTERNATIVE FORMS OF REMUNERATION IN THE WEALTH MANAGEMENT INDUSTRY 2 (rev. 2010).

[162] *Corporations Act 2001* (Cth) s 963D (Austl.). {*Corporations Act 2001* (Cth) s 963D.} "Basic banking product" includes most savings, transaction accounts, and term deposits; associated non-cash payment facilities, such as check and payment facilities; and traveler's checks. *Id.* s 961F {Ibid s 961F}; *see also id.* s 761A {Ibid s. 761A} (defining "basic deposit account," a type of basic banking product).

[163] An important example is consumer credit insurance which, in Australia, frequently comprises both a general insurance and a life insurance policy sold in tandem. The Corporations Act provides that not only must access to or the amount of the benefit be solely dependent on recommending a basic deposit product, but the adviser, in the ordinary course of giving that advice, must not give advice on any other financial product. *Id.* s 963D(c). {Corporations Act s 963D.}

concerns regarding these exemptions by proposing further exemptions.[164] These proposals provide more flexible exemptions for banking and insurance products,[165] yet they still retain restrictions which have the potential to artificially limit their usefulness. In particular, the new exemption for banking products permits benefits relating to banking products, general insurance, and non-financial products,[166] but does not permit advice to be given about any other product "at the same time."[167] This approach invites uncertainty about when an adviser can advise a client on other products. Intermingled advice can obviously not be given. However, questions remain as to whether the same adviser can complete giving advice on a particular product and then move on to giving advice on another product without infringing the conflicted remuneration ban.

There is a problem for life insurance as a result of the exclusion from the exemption of certain types of life insurance made through superannuation. This ban arises from the government's goal to prohibit commissions taken from compulsory superannuation account balances, including in relation to life insurance made available through superannuation. After intense debate, the government agreed to limit the ban to superannuation members who do not seek or require advice on their superannuation insurance benefits. The concern was that otherwise the regime would, in fact, create a new conflict for advisers.[168] The government has attempted to address this problem by limiting the ban to default and group insurance arrangements, but this attempt has not fully resolved the industry's concerns.[169]

[164] *Draft Corporations Amendment Regulation 2012* (Cth) regs 7.7A.4.12, 7.7A.4.13 (Austl.). {Draft Corporations Regulations 7.7A.4.12 and 7.7A.4.13.}

[165] For example, benefits relating to combined general and life insurance products will be permitted. *Id.* reg 7.7A.4.12. {Draft Corporations Regulation 7.7A.4.12.}

[166] This term is not defined but is understood to include loans.

[167] *Draft Corporations Amendment Regulation 2012* (Cth) regs 7.7A.4.12, 7.7A.4.13 (Austl.). {Draft Corporations Regulations 7.7A.4.12 and 7.7A.4.13.}

[168] As commission can be paid on life insurance acquired directly by clients, different remuneration outcomes would arise depending on whether an adviser recommends acquiring life insurance directly or through a superannuation fund.

[169] This non-resolution is because group insurance arrangements through superannuation can include both automatic cover and cover underwritten by the insurer where, therefore, advisers are typically involved.

3. Execution-Only Benefits

There is no need for an execution-only exemption where no financial product advice is ever given to the client. This is because conflicted remuneration is banned only where benefits could reasonably be expected to influence advice. FOFA does not apply to remuneration that influences investment decisions where no advice is given. Providers of retail investment mandates or managed discretionary accounts, as they are known in Australia,[170] are only subject to the ban on conflicted remuneration if they also provide retail advice. Furthermore, the ban only applies to advisers and their licensee—it does not apply to remuneration received by associates.[171]

However, there is a risk the ban could apply to licensee remuneration where the licensee is responsible for both advice and investment decisions. There are also concerns where an adviser performs execution-only services for a client at a later date.

FOFA addresses these concerns by including an exemption where a benefit is given in relation to the issue or sale of a financial product to a person by a licensee or representative and no advice has been given about that product or similar products by the licensee or representative in the twelve months before the benefit is given.[172] The government said the following of this exemption:

> This is proposed to avoid a situation where a licensee or representative can never receive remuneration of an execution-only type if it has ever provided financial product advice to the retail client. Where the financial product advice is remote with respect to the issue or sale of the financial product—that is, it

[170] AUSTRALIAN SEC. & INVS. COMM'N, REGULATORY GUIDE 179, MANAGED DISCRETIONARY ACCOUNT SERVICES 3 (2004), *available at* http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ps179.pdf/$file/ps179.pdf. {Australian Securities and Investments Commission, *Managed Discretionary Account Services*, Regulatory Guide 179, March 2004 ('ASIC Regulatory Guide 179') at 3.}

[171] The duty to give priority to client interests requires advisers to place client interests ahead of those of associates, but this duty also only applies "when giving the advice." *Corporations Act 2001* (Cth) s 961J(1) (Austl.). {*Corporations Act 2001* (Cth) s 961J(1).}

[172] *Id.* s 963B(1)(c). {Ibid 963B(1)(c).}

took place over 12 months before the issue or sale—it will not deny the licensee or representative the benefit of paragraph 963B(c).[173]

This exemption applies only to the issue or sale of a product. It does not apply to the acquisition, redemption, or variation of a product.[174]

4. Brokerage

Possibly in recognition of the limitations of the execution-only exemption, the government has proposed an exemption for sharing brokerage fees[175] with broker representatives. The benefit must not be more than 100% of the brokerage fee, the brokerage fee must be value-based, and the provider must be a market participant and have anti-churning arrangements in place.[176]

However, the proposed exemption has problems. First, it applies only to representatives of market participants—it would not, therefore, be possible to share brokerage fees with other licensees or financial planners who refer clients to the broker. Second, it applies only to brokerage fees calculated by reference to the value of the product traded—however, dollar-based brokerage fees can also be conflicted remuneration where they may influence a recommendation to trade securities. Third, there are concerns about the requirement for "anti-churning arrangements," which require arrangements to ensure that the size or frequency of transactions entered into by a provider for a retail client is appropriate, and that the provider takes into account the investment objectives, financial situation, and needs

[173] Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (Cth) para 1.11 (Austl.) (emphasis removed). {Supplementary Explanatory Memorandum to Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 tabled in the House of Representatives, [1.11].}

[174] The exemption will not, therefore, apply in the following circumstances: (1) the purchase of a share on a stock exchange; (2) the redemption of a managed fund or superannuation interest; and (3) the variation of a product, for example, switching between investment options or increasing the sum insured.

[175] "Brokerage fee" is defined as a fee based on the value of the product traded, which is given by a retail client to a provider in consideration for the provider to deal, on behalf of the retail client, in a financial product that is admitted for quotation on a prescribed Australian or foreign financial market. *Draft Corporations Amendment Regulation 2012* (Cth) reg 7.7A.4.12(7) (Austl.). {Draft Corporations Regulation 7.7A.4.12(7).}

[176] *Id.* reg 7.7A.4.12(6). {Draft Corporations Regulation 7.7A.4.12(6).}

of the client. As trades are often conducted in a no- or limited advice context, it will be difficult for brokers to satisfy this criteria.

5. Stamping Fees

There is a proposed exemption from the ban on conflicted remuneration for fees—known as "stamping fees"—paid by a company to a financial services licensee or authorized representative for raising capital or debt on its behalf.[177] The exemption is proposed to address concerns that the conflicted remuneration ban would otherwise have an adverse impact on the ability to raise capital in the Australian market. It has been welcomed by industry, particularly as it is not limited to broker representatives but extends to both "direct and indirect market participants."[178]

However, the proposal to restrict the exemption to companies is unduly restrictive and would create anomalies in Australia's capital markets, leading to an inappropriate bias towards corporate fundraising activities to the detriment of fundraising activities relating to other types of entities, in particular, trust structures. There is no tangible reason why the stamping exemption should not apply to benefits given by other forms of listed entities and there are many good commercial reasons why a company is not the appropriate vehicle for a listed entity.[179]

The limitation appears to reflect a concern by the government that permitting the exemption to apply to trusts, which is the normal structure for managed funds in Australia, would mean that the exemption could have unintended consequences. However, the exemption is restricted to listed entities, which would prevent its application to many investment trusts.

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[177] *Id.* reg 7.7A.4.12(4). {Draft Corporations Regulation 7.7A.4.12(4).}

[178] Further FOFA Bill Revised Explanatory Memorandum, *supra* note 33, at 30–31. {Further FOFA Bill Revised Explanatory Memorandum, above n 33, 31, [2.29].}

[179] It is common in Australia for property and infrastructure assets to be held through a listed trust such as a real estate investment trust ("REIT"). The units of such trusts may or may not be stapled to the units of another trust or the shares of one or more companies, thereby becoming a "stapled security."

There is also a specific exemption for listed investment companies,[180] which could equally apply to listed trusts to achieve the government's apparent objective of excluding managed investment schemes which primarily invest in other schemes or securities. However, one problem with the proposed limitation is that both listed companies and trusts invest in other financial products in the form of securities and interests issued by subsidiaries and special purpose vehicles. If read strictly, it could mean that the exemption is rarely or never available.

6. "Soft Dollar" Benefits

The ban on conflicted remuneration applies to both monetary and non-monetary benefits.[181] While some of the above exemptions only apply to monetary benefits,[182] the following additional non-monetary benefits are permitted: benefits of less than 300 AUD, provided identical or similar benefits are not given on a frequent or regular basis;[183] benefits which have a genuine education or training purpose relevant to the provision of financial product advice to retail clients—this purpose must be the dominant purpose unless it is a training course, conference, or seminar, in which case the lesser of seventy-five percent of the time spent on the course or six hours a day must be spent on educational or training activities for professional development, and the participant or his or her employer must pay costs relating to travel, accommodation, functions, and events;[184] the provision of information technology software or support related to the provision of financial product advice to retail clients in relation to the financial products issued or sold by the benefit

[180] *Draft Corporations Amendment Regulation 2012* (Cth) reg 7.7A.4.12(5) (Austl.) {Draft Corporations Regulation 7.7A.4.12(5)} (providing that the exemption "does not apply if the company has the primary purpose of investing in financial products").

[181] *Corporations Act 2001* (Cth) s 963A (Austl.). {*Corporations Act 2001* (Cth) s 963A.}

[182] The exemptions for life insurance, execution-only services, and brokerage and stamping fees do not apply to non-monetary benefits.

[183] *See Corporations Act 2001* (Cth) s 963C(b) (Austl.) {*Corporations Act 2001* (Cth) s 963C(b)}; *Draft Corporations Amendment Regulation 2012* (Cth) reg 7.7A.13 (Austl.) {Corporations Regulation 7.7A.13}; Further FOFA Bill Revised Explanatory Memorandum, *supra* note 33, at 24 {Further FOFA Bill Revised Explanatory Memorandum, above n 33, 24}.

[184] *Corporations Act 2001* (Cth) s 963C(c) (Austl.) {*Corporations Act 2001* (Cth) s 963C(c)}; *Draft Corporations Amendment Regulation 2012* (Cth) reg 7.7A.14 (Austl.) {Corporations Regulation 7.7A.14.}.

provider[185]—the exemption only applies to product providers and not generally to licensees responsible for advisers on the basis that:

> such benefits would not generally be provided in circumstances where they could reasonably be expected to influence advice. However, IT software and support benefits provided by licensees will be prohibited if they could reasonably be expected to influence advice, for example, where the benefit is provided as a reward for product sales.[186]

These exemptions carry forward the existing exemptions in the industry code of practice on alternative forms of remuneration.[187] They further demonstrate the theme of replacing principles-based regulation with greater prescription as the translation of this industry standard to statute has led to a more restrictive regime for "soft dollar" benefits.[188]

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[185] *Corporations Act 2011* (Cth) s 963C(d) (Austl.) {*Corporations Act 2001* (Cth) s 963C(d).} The example provided of such a benefit is "the provision of software to access a platform or access to a website to place orders." Further FOFA Bill Revised Explanatory Memorandum, *supra* note 33, at 34. {Further FOFA Bill Revised Explanatory Memorandum, above n 33, 34, [2.44].}

[186] Further FOFA Bill Revised Explanatory Memorandum, *supra* note 33, at 34. {Further FOFA Bill Revised Explanatory Memorandum, above n 33, 34, [2.45].}

[187] *See generally* FIN. SERVS. COUNCIL & FIN. PLANNING ASS'N, *supra* note 161. {FSC/FPA Industry Code of Practice on Alternative Forms of Remuneration in the Wealth Management Industry<http://www.fsc.org.au/downloads/file/FSCStandards/14S_Jan_2010_JointCodeofPracticeonAlternativeformsofRemuneration.pdf> accessed 18 September 2012.}

[188] In particular, the restrictions on education and training-related benefits exemption seem to demonstrate the government's distrust of the industry. There was discussion of imposing further restrictions to limit the exemption to courses and conferences in Australia or New Zealand, but free trade concerns seem to have stayed the government's hand so far. There are also concerns about the requirement in *Corporations Act 2001* (Cth) s 963C(c)(ii) (Austl.) {*Corporations Act 2001* (Cth) s 963C(c)(ii)} that the benefit be "related to the provision of financial product advice." This requirement appears to preclude training relating to dealing activities or general business management and development unless a broad view of "related to" is taken.

E. Shelf-Space Fee Ban

The legislation prohibits platform operators[189] from accepting "volume-based shelf-space fees."[190] A benefit is presumed to be a volume-based shelf-space fee if the benefit, or its value, depends wholly or partly on the total number or value of a product issuer's financial products to which the custodial arrangement relates. The purpose of the ban is "to capture benefits provided in return for a greater number or value of the funds manager's financial products about which information is to be included on the platform."[191]

There are exceptions if it is proved that all or part of the benefit is either:

> (a) a reasonable fee for a service provided to the funds manager by the platform operator or another person"; [or]
> (b) [a discount or rebate] the value of which does not exceed an amount that may reasonably be attributed to efficiencies gained by the funds manager because of the number or value of financial products in relation to which the funds manager provides services to the platform operator, or through the platform operator to another person.[192]

While these exceptions have been welcomed by the industry, they pose technical difficulties. The only service provided by a platform operator is normally the right to be included on the platform—hence the term "shelf-space fee." This exception seems either to be available only where other services are also provided, or where the fee is "reasonable," which presumably means consistent with other such fees paid to other product issuers or by other platform operators. However, the government states the following:

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[189] These are products through which clients can acquire a range of other, sometimes wholesale, products. Platforms are typically available to retail clients in Australia only through financial planners. Commercially, platforms can be purely an administrative arrangement or can include a custodial element where products are held on trust for clients. The shelf-space fee ban only applies to the latter as a result of the definition of custodial arrangement in section 964. While this term is typically used for retail offers, the ban itself does not seem to be limited to such offers but appears technically to apply to platforms available only to wholesale clients as well.

[190] *Corporations Act 2001* (Cth) s 964A (Austl.). {*Corporations Act 2001* (Cth) s 964A.}

[191] Further FOFA Bill Revised Explanatory Memorandum, *supra* note 33, at 38. {Further FOFA Bill Revised Explanatory Memorandum, above n 33, 68, [2.64].}

[192] *Corporations Act 2001* (Cth) s 964A(3) (Austl.). {*Corporations Act 2001* (Cth) s 964A(3).}

> The Bill establishes a ban on the receipt by platform operators of volume-based benefits to the extent that such incentives are merely a means of product issuers or funds managers 'purchasing' shelf space or preferential positions on administration platforms. However, the Bill does not purport to ban fund managers lowering their fees to platform operators (in the form of scale-based discounts or rebates) where such discounts or rebates represent reasonable value for scale.[193]
>
> . . . .
>
> In cases where the scale discount or rebate exceeds the reasonable value of scale efficiencies, it is considered that the benefit is intended to gain a placement on a platform or preferential treatment on a platform (for example, a position on a 'model portfolio' or 'menu selection').[194]

In relation to the second exception, it is not clear that most product issuers do in fact gain any efficiencies by gaining access to clients through platforms, except to the extent that it is significantly cheaper to distribute products through platforms than directly to clients. Quantifying such "efficiencies" is likely to be challenging. The government simply indicates that "the relative bargaining power between the particular funds manager and the platform operator" can be taken into account.[195]

The ban only applies to platform operators accepting such fees. It does not apply to the product issuer paying the fee.

F. Ban on Charging Asset-Based Fees on Borrowed Amounts

There is a further important ban in the FOFA legislation. As noted above, the collapse of Storm Financial and its financial model was a significant reason for the introduction of the new regime.[196] There was evidence that clients were advised to borrow significant sums, which were not appropriate to their circumstances. As Storm Financial fees and the remuneration of its advisers were based on funds under advice, there was a significant incentive to recommend high levels of gearing by clients.

[193] Further FOFA Bill Revised Explanatory Memorandum, *supra* note 33, at 37. {Further FOFA Bill Revised Explanatory Memorandum, above n 33, 37, [2.61].}

[194] *Id.* at 38. {Ibid 38, [2.66].}

[195] *Id.* {Ibid 38, [2.67].}

[196] *See supra* note 134 and accompanying text.

Subsequent credit regulation has rectified the issue to some extent by imposing an obligation on lenders to assess whether the credit provided is not unsuitable for the client.[197] However, FOFA takes one step further by banning a licensee or representative who provides retail advice—personal or general advice—from charging an asset-based fee[198] on a borrowed amount used or to be used to acquire financial products by or on behalf of the client.[199]

The ban will not apply if it is not reasonably apparent to a prudent adviser[200] that the amount has been borrowed.[201] The government gives the example of the client who deliberately conceals the fact that the funds are borrowed.[202] However, the adviser remains responsible for making reasonable inquiries to obtain complete and accurate information.[203]

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[197] *National Consumer Credit Protection Act 2009* (Cth) pt 3-2, divs 3–4 (Austl.) {*National Consumer Credit Protection Act 2009* (Cth) Part 3-2, Divisions 3 and 4}; *Corporations Act 2001* (Cth) ss 985EA–985K (Austl.) {Corporations Act Part 7.8, Division 4A, Subdivision A}. However, these provisions apply to loans for personal, domestic, household, or residential investment property purposes, and margin loans respectively. Other investment loans are not currently regulated. *National Consumer Credit Protection Act 2009* (Cth) s 5(3) (Austl.). {National Credit Code s 5(3).} The government has issued a consultation paper which, among other things, sought submissions on whether other types of investment loans should be regulated. *See* THE TREASURY, AUSTRALIAN GOV'T, NATIONAL CREDIT REFORM: ENHANCING CONFIDENCE AND FAIRNESS IN AUSTRALIA'S CREDIT LAW—GREEN PAPER 49–56 (2010), *available at* http://archive.treasury.gov.au/documents/1852/PDF/National_Credit_Reform_Green_Paper.pdf. {'National Credit Reform—Enhancing Confidence and Fairness in Australia's Credit Law' (Green Paper, July 2010).}

[198] Asset-based fee is defined as "dependent upon the amount of funds used or to be used to acquire financial products by or on behalf of" the client. *Corporations Act 2001* (Cth) s 964F (Austl.). {*Corporations Act 2001* (Cth) s 964A.}

[199] Liability for breaching the ban attaches to the licensee where its representative charges the fee, unless they are an authorized representative. *Id.* ss 964D(2), 964E. {*Corporations Act 2001* (Cth) ss 964D(2), 964E.} Authorized representatives are not normally employees of the licensee.

[200] A prudent advisor is a person with a "reasonable level of expertise in the subject matter of the advice" who exercises care and objectively assesses the information. *Id.* s 964H {*Corporations Act 2001* (Cth) s 964H}; Further FOFA Bill Revised Explanatory Memorandum, *supra* note 33, at 39 {Further FOFA Bill Revised Explanatory Memorandum, above n 33, 39, [2.73]}.

[201] *Corporations Act 2001* (Cth) ss 964D(3), 964E(2) (Austl.). {*Corporations Act 2001* (Cth) ss 964D(3), 964E(2).}

[202] Further FOFA Bill Revised Explanatory Memorandum, *supra* note 33, at 39. {Further FOFA Bill Revised Explanatory Memorandum, above n 33, 39, [2.73].}

[203] *Corporations Act 2001* (Cth) ss 964D(5), 964E(4) (Austl.). {*Corporations Act 2001* (Cth) ss 964D(5), 964E(4).}

G. Grandfathering

Each of the elements of FOFA have their own grandfathering measures.[204] The regime for conflicted remuneration is, however, currently very unclear. The legislation appears to grandfather any remuneration paid under a remuneration arrangement entered into before commencement, whether it relates to new or existing clients.[205] Yet, there is currently no grandfathering for payments made by platform operators.[206] There is a proposal to limit grandfathering so it does not apply to investments made by new or existing clients after the licensee's FOFA commencement date;[207] however, this regulation is yet to be made. It is also understood that some form of grandfathering will apply to payments by platform operators, however this measure is yet to be released for consultation. The position regarding grandfathering is, therefore, currently very unsatisfactory and significantly affects the ability of industry to implement the necessary changes to comply with FOFA.

V. ONGOING FEE ARRANGEMENTS

The third limb of FOFA is regulation of ongoing fee arrangements between advisers and clients.[208] These requirements come from a different direction than the conflicted remuneration ban which is primarily about payments received by advisers and licensees from product issuers and employers.[209]

[204] In the case of the best interests duty, this grandfathering is very limited.

[205] *Corporations Act 2001* (Cth) ss 1528–1529. {*Corporations Act 2001* (Cth) ss 1528, 1529.} The ban on asset-based fees charged on borrowed amounts applies to all fees charged after the licensee election date or July 1, 2013, whichever is later. *Id.* s 1531. {Ibid s 1531.}

[206] *Id.* s 1528(1)(b). {*Corporations Act 2001* (Cth) s 1528(1)(b).}

[207] *Draft Corporations Amendment Regulation 2012* (Cth) reg 7.7A.4.16 (Austl.). {Draft Corporations Regulation 7.7A.4.16.}

[208] *Corporations Act 2001* (Cth) pt 7.7A, div 3 (Austl.). {*Corporations Act 2001* (Cth) Part 7.7A, Division 3.}

[209] The main exception is the ban on charging asset-based fees on borrowed amounts, which applies to both commission and client fee arrangements.

The focus here is on arrangements where personal advice is provided and fees are to be paid for more than twelve months. This applies to a fee "however described or structured."[210] One-off fees and payment plans are not affected unless they form part of an ongoing fee arrangement.[211]

This limb addresses remuneration received from clients, although it may not be confined to this. The provisions do not explicitly state whether they apply to fees received from other parties or whether commissions and similar types of payments can be viewed as "fees." The language refers to "under the terms of the arrangement, a fee . . . is to be paid,"[212] without specifying that the fee must be paid by the client rather than a third party such as a product issuer. In any case, client "given" benefits, which are exempt from the ban on conflicted remuneration, will be subject to the ongoing fee arrangement obligations.

It is unclear whether this regulates trailing commissions, which are undoubtedly arrangements for the payment of remuneration for more than twelve months. There are arguments that they are not regulated as ongoing fee arrangements.[213]

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[210] *Corporations Act 2001* (Cth) ss 962A(1)(c), (2)(c) (Austl.). {*Corporations Act 2001* (Cth) ss 962A(1)(c), 962A(2)(c).}

[211] *Id.* ss 962A(1)–(3). {Ibid ss 962A(1)–(3).} While the regime only applies if the arrangement includes a fee which is to be paid during a period of more than twelve months, the disclosure obligations appear to apply to all fees payable under the arrangement, including one-off fees and fees paid under a payment plan.

[212] *Id.* ss 962A(1)(c), (2)(c). {*Corporations Act 2001* (Cth) Part 7.7A s 962A(1)(c), 962A(2)(c).}

[213] An ongoing fee arrangement with a retail client is where a fee is to be paid under the terms of the arrangement. *Id.* ss 962A(1), (2). {Ibid ss 962A(1), 962A(2).} A trailing commission must be disclosed to the client who may agree to its receipt. However, it is paid under an arrangement between the licensee or adviser and the product issuer, and not under the arrangement with the client. Furthermore, the fee disclosure statement only has to disclose fees "paid . . . by the client." *Id.* s 962H(2)(a). {Ibid s 962H(2)(a).} It is not clear whether this arrangement is in line with the government's view. While the Explanatory Memorandum does not refer to commissions in relation to division 3, the Minister's second reading speech stated the following: "Some clients are unaware of the amount of [ongoing] fees and continue paying them because they are disengaged. This scenario can arise both where the advice fee is paid via a third party product *commission*, and directly from the client to adviser." Cth, Parliamentary Debates, House of Representatives, 13 Oct. 2011, 11797 (Bill Shorten, Assistant Treasurer and Minister for Financial Services and Superannuation) (Austl.) (emphasis added).

The following requirements apply to ongoing fee arrangements: (1) clients must be provided with an annual fee disclosure statement;[214] (2) clients can opt out of the ongoing fee arrangement at any time;[215] (3) clients must be provided with a renewal notice every two years;[216] (4) the ongoing fee arrangement will automatically terminate if the fee disclosure statement or renewal notice requirements are not met[217] or two years and sixty days after the previous renewal notice, unless the client actively renews the arrangement.[218]

A. *Fee Disclosure Statements*

Fee disclosure statements must include the following: (1) the amount of each fee paid by the client under the arrangement[219] in the previous year; (2) the amount of each fee that the current fee recipient anticipates that the client will pay under the arrangement in the next twelve months; (3) information about the services that the client was entitled to receive from the current and any previous fee recipient under the arrangement during the previous year; and (4) information about the services that the client actually received during the previous year.[220] The fee disclosure statements must be given within thirty days after being prepared.[221]

B. *Renewal Notices*

The renewal notice is required to contain the following prescribed statements: (1) the client may renew the arrangement by notifying the current fee recipient; (2) the arrangement will

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[214] *Corporations Act 2001* (Cth) s 962G (Austl.). {*Corporations Act 2001* (Cth) s 962G.}

[215] *Id.* s 962E(1). {Ibid s 962E(1).}

[216] *Id.* ss 962K, 962L. {Ibid ss 962K, 962L.}

[217] *Id.* s 962F. {*Corporations Act 2001* (Cth) s 962F.} Payment of a fee after automatic termination does not waive the effect of non-compliance. However, the fee recipient is not required to refund such a payment unless required by court. *See id.* ss 962F(2)–(3), 1317GA. {*Corporations Act 2001* ss 962F(2), 962F(3) and 1317GA.} Charging a fee after the arrangement terminates for any reason is, however, a breach of a civil penalty provision. *Id.* s 962P. {Ibid s 962P.}

[218] *Id.* ss 962L(2), 962N. {*Corporations Act 2001* (Cth) s 962L(2) and 962N.}

[219] The provision uses the term "ongoing fee." However, this term is defined as any fee payable under an ongoing fee arrangement without specifying that the fee must be paid over more than twelve months. *Id.* s 962B. {Ibid s 962B.}

[220] *Id.* s 962H(2). {Ibid s 962H(2).}

[221] *Id.* s 962H(1)(b)(i). {Ibid s 962H(1)(b)(i).}

terminate, and no further advice will be provided or fee charged under it, if the client does not elect to renew the arrangement; and (3) the client will be taken to have elected not to renew the arrangement if the client does not give the current fee recipient notice in writing of an election to renew within thirty days after the renewal notice and fee disclosure statement is given to the client.[222]

A last minute amendment to the regime gave ASIC the power to provide an exemption from the renewal notice obligation and therefore the requirement for clients to opt-in every two years where the fee recipient is bound by an ASIC-approved code of conduct. ASIC will only approve a code for this purpose if ASIC is satisfied "the code of conduct obviates the need for persons bound by the code to be bound by the opt-in requirement."[223]

The inclusion of this provision in the legislation was controversial and was thought at the time to favor certain industry bodies over others.[224] There has not been much indication either at the time or subsequently of what such a code will be required to contain. Speculation that ASIC would in any case require a code to contain equivalent provisions initially seemed misplaced based on the Minister's statements at the time the amendment was made.[225] However, more recent statements by ASIC suggest that this view may be correct.[226]

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[222] *Id.* s 962K(2). {Ibid s 962K(2).}

[223] *Id.* s 962CA. {Ibid s 962CA.} ASIC is undertaking a review of REGULATORY GUIDE 183, which sets out ASIC's approach to approving codes of practice.

[224] *See, e.g.*, Press Release, Ass'n of Fin. Advisers, Tricky Politics Blight FOFA Reform (Mar. 22, 2012). {For example, see Association of Financial Advisers, 'Tricky Politics Blight FOFA Reform' (Media Release, 22 March 2012).}

[225] The Minister, stating when tabling the amendment, that it "gives ASIC the ability to exempt advisers from the opt-in obligation if they are satisfied that the adviser has signed up to a professional code which obviates the need for opt-in." Cth, Parliamentary Debates, House of Representatives, 22 Mar. 2012, 4043 (Bill Shorten, Minister for Financial Services and Superannuation and Minister for Employment and Workplace Relations) (Austl.). {House Hansard, 22 March 2012, 4024.}

[226] Peter Kell, Comm'r, Australian Sec. & Invs. Comm'n, Speech at the Association of Financial Advisers National Roadshow, Brisbane (July 26, 2012), *in* ASIC'S FINANCIAL ADVISER WORK FOR 2012–13, at 10 {Australian Securities and Investments Commissioner Peter Kell, 'ASIC's Financial Adviser Work for 2012–13' (Speech delivered to the Association of Financial Advisers National Roadshow, Brisbane, 26 July 2012)} ("As for 'obviating the need' for opt-in, we expect approved codes to contain provisions that will achieve substantially the same outcomes as the opt-in requirement intends to achieve. That is, we expect to see engaged clients who receive agreed services for any ongoing fees that they pay.").

VI. ANTI-AVOIDANCE

The FOFA reforms introduce an anti-avoidance prohibition which applies to the obligations in part 7.7A. Section 965 states that a person must not enter into, begin to carry out, or carry out a scheme for the sole purpose or for a purpose—that is not incidental—of avoiding application of any provision of the new part 7.7A of the Act, and the scheme has achieved this purpose.[227]

This anti-avoidance measure has some significant challenges for the industry. It is very strict.[228] The measure applies not only to entering into or beginning to carry out a scheme but also to carrying out the scheme.[229] This application may mean that steps taken before the commencement of FOFA may still be impugned under section 965 if the scheme is carried out after commencement.[230]

There are also concerns that structuring activities to fall within an exemption may be enough to fall afoul of the prohibition. This conclusion does not seem reasonable. However, it demonstrates the uncertainty created by the provision, particularly as it is possible to imagine circumstances where structuring to fall within an exemption should be regarded as avoidance.

It is also important to recognize that while some elements of FOFA do not commence until the earlier of a licensee electing to comply or July 1, 2013, the anti-avoidance measure commenced on July 1, 2012. This means that while arrangements entered into after July 1, 2012 may be legal currently, they may still breach the anti-avoidance measure if a purpose is to avoid the application of FOFA after July 1, 2013.

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[227] *Corporations Act 2001* (Cth) s 965 (Austl.). {*Corporations Act 2001* (Cth) s 965.}

[228] Extending the prohibition beyond sole or dominant purposes to non-incidental purposes makes this anti-avoidance measure stricter than the equivalent tax anti-avoidance provision.

[229] *See Corporations Act 2001* (Cth) s 965 (Austl.). {*Corporations Act 2001* (Cth) s 965.}

[230] The equivalent tax provision specifically carves out schemes entered into before the commencement of the provision.

CONCLUSION

The FOFA reforms are disappointing for both consumers and the industry—although from different perspectives. Central to both is the lack of clarity of a number of provisions. The problem from a consumer protection perspective is to ensure that intervention in the market forestalls the kinds of commission-driven selling of inappropriate products and eventual collapse of investment schemes. Industry requires clarity so that it understands its compliance obligations. The public policy imperative is to ensure that Australians are able to accumulate and maintain savings and investments for retirement with appropriate financial advice. The principle-based approach of the unreformed legislation did not prevent market failures in the advice industry and loss to individuals. The question is whether the regulatory scheme was the cause and whether the FOFA regime will do any better. By prescribing the steps that can be followed to achieve the best interests of the client and by prescribing priority to the client in the case of any client, the legislation sets out a path towards good advice. Certain practices are proscribed and banned. Advisers can no longer receive conflicted remuneration. But we have seen that the lack of clarity in these provisions means that although remuneration models will change, the change may not be as radical as some advocating for the retail client may have hoped.

The bottom line is that regulation is only as good as its enforcement. ASIC has expressed concerns about its regulatory powers and these concerns have been addressed. Prescriptive and proscriptive regulation is generally perceived by regulators as being easier to enforce than principle- or risk-based regulation. However, no form of regulation will prevent market failure or fraud. Prevention requires active, informed, and empowered enforcement coupled with an effective regulatory regime—one that is both flexible enough to respond to market changes and specific enough to provide certainty. There is a significant question whether Australia's FOFA regime meets this test.