The Best Interests Duty in the Future of Financial Advice Reforms: Striking a Balance between Certainty and Flexibility

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Structure of presentation

- Background and context of FOFA reforms
- Scope of best interests duty
- Assessing likely effectiveness of best interest duty as consumer protection measure
Background and context of FOFA reforms

- **Inquiry in to Financial Products and Services in Australia** *(Ripoll report)* following collapse of Storm
- Failure of pre-existing law: relied on “efficient market” hypothesis; focus on promoting **transparency** through **disclosure** obligations and PDS rather than quality of advice
- Objectives of new law: Improve **quality** of financial advice to retail consumers; facilitate greater **access** to financial advice
- Recommended that financial advisers be subject to **fiduciary duty**
Background and context of FOFA reforms

- **Corporations Agreement 2002**: State referral of legislative power and enactment of national law for regulation of financial products and services:
  Cl 301(1) *the Commission will have sole responsibility for the general administration of the national law*

- **Intergovernmental Agreement for the Australian Consumer Law 2009**:  
  Cl 3.1.1 *the Commonwealth will enact the text of the ACL;*
  Cl 3.1.3 *the Commonwealth will enact changes to the investor protections of the ASIC Act 2001 and the Corps Act 2001 to ensure that they are consistent with the ACL*
Background and context of FOFA reforms

- ACL: consumer guarantees in relation to the supply of goods and services to consumers; statutory duties; failure to comply gives rise to statutory causes of action
- Supply of professional services to consumers
  ACL, 60: due care and skill
  ACL, s 61: fitness for purpose or desired result
- CCA, s 131A(1): ACL (other than Pt 5-5 of Sch 2) does not apply to the supply, or possible supply, of services that are financial services
Background and context of FOFA reforms

ASIC Act amended:

- New provisions regulating unfair terms and unconscionable conduct provisions
- But no consumer guarantees for financial services
- ASIC Act s 12ED(1): implied warranty of due care and skill
- ASIC Act s 12ED(2): implied warranty of fitness for purpose and that desired result will be achieved
Scope of best interests duty

- Fiduciary duty not adopted
- Corporations Act 2001 (Cth), s 961B(1): the provider must act in the **best interests** of the client in relation to the advice
- s 961B(2): the provider satisfies duty in (1) if provider proves provider has done each of the following:
Scope of best interests duty

CA, s 961B(2)(a): identified the objectives, financial situation and needs of the client (client’s relevant circumstances) that were disclosed to the provider by the client through instructions

- Client may not know what objectives, situation and needs of client are
- Advisers must clarify instructions and exercise judgment when client seeks advice about life events
CA, s 961B(2)(b): identified the subject matter of the advice and the client’s relevant circumstances that would be relevant to the advice

- Scope of the advice will depend on subject matter of the advice sought (what the client is seeking advice about);
- Outcomes client is seeking to achieve; how much client is willing to pay; risk profile
- Advice of different subject matter may be better suited to client’s objectives
- Exercise judgment in deciding scope of advice, based on subject matter
Scope of best interests duty

CA, s 961B(2)(c): where it was *reasonably apparent* that information relating to client’s relevant circumstances was *incomplete or inaccurate*, made *reasonable* inquiries to obtain complete and accurate information.

- Objective test: CA, s961C:
  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 by the provider.

- threshold increases if subject matter of advice is highly complex and technical.
Scope of best interests duty

CA, s 961B(2)(d): assessed whether provider has *expertise required* to provide advice sought, and, if not declined

- Consider provider’s professional qualifications and training; knowledge and skills in advising about the product or strategy being recommended
Scope of best interests duty

CA, s 961B(2)(e): If...it would be reasonable, conducted a reasonable investigation into the financial products that might achieve the client’s objectives; and assessed the information gathered in the investigation

- Objective test: not necessary to conduct an investigation in all cases;
- Limit scope of advice according to needs and objectives of client;
- Advisers may be required to give advice beyond approved product list
Scope of best interests duty

CA, s 961B(2)(f): based all judgments in advising the client on the client’s relevant circumstances

- re-affirms that objectives, situation and needs of client are the paramount consideration
- May require adviser to provide non-product specific advice (debt levels, estate planning, Centrelink benefits)
Scope of best interests duty

CA, s 961B(2)(g): taken any other step that would reasonably be regarded as being in the client’s best interests

- Objective test CA, s 961E:

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

- CA, s 961J: associated duty of priority:
- requires providers to give priority to their clients’ interests where they know, or reasonably ought to know, that there is a conflict between the client’s interests and the interests of the provider and associated parties
Scope of best interests duty

- Best interest duty, **not a fiduciary duty**
- Fiduciary duty in Australia is **proscriptive** (negative duties), not prescriptive (positive duties)
- Fiduciaries must act in clients’ interests, but not necessarily their *best* interests
- Imposing fiduciary duty would not have achieved objective of improving **quality** and promoting confidence
- Does bests interests duty have a ‘fiduciary character’?
- RIS: “**introducing a fiduciary-like statutory duty to act in the best interests of clients, subject to a ‘reasonable steps’ qualification**”
Assessing best interests duty

**Flexibility**: Will s 961B (1) improve the **quality** of financial advice?

- Best interests requires advice providers to take positive steps to provide **flexible**, individualised advice to meet each client’s particular needs
- But CA, s 961B(2): may promote minimum compliance: “box ticking mentality”; do the minimum to satisfy each step and no more
Assessing best interests duty

**Flexibility**: Will s 961B facilitate greater access to advice?

- One way to facilitate access is to facilitate provision of scaled advice.
- Legislative note to s 961B(2)(g):
  The matters that must be proved under subsection (2) relate to the subject matter of the advice sought by the client and the circumstances of the client relevant to that subject matter ... That subject matter and the client’s relevant circumstances may be broad or narrow, and so the subsection anticipates that a client may seek scaled advice and that the inquiries made by the provider will be tailored to the advice sought.
Certainty for advisers?

Does s 961B provide **certainty for advisers**?

- Term ‘best interests’ is not defined
- Not clear whether ‘best interests’ will be construed in the same way as it has in other legislative contexts
- Not clear whether ‘best interests’ is to be treated as a ‘fiduciary-like’ duty
- ‘catch all’ provision CA, s 961B(2)(g) uncertain
- Not clear how ‘best interests’ duty relates to pre-existing common law protections: duty of care and fiduciary duty and ASIC Act, s 12ED implied warranties of due care and skill and fitness for purpose and desired result will be achieved
Certainty for consumers?

- Does s 961B provide **certainty for consumers**?
- CA s 961K and s961Q: Financial Services Licensee or authorised representative that contravenes s 961B or s961J is liable to pay a **civil penalty**
- CA s 961M: court can make compensation orders in respect of loss or damage for breach of s 961B or s961J (on its own initiative; application by ASIC; or application by client)
- Lack of awareness of rights; uncertainty as to scope of best interests duty
Will benefits or flexibility outweigh costs of uncertainty?

- Uncertainty will **increase compliance costs**
  - Costs associated with tailoring advice
  - Costs associated with more professional indemnity insurance

- RIS merely notes that ‘**costs will be incurred as firms are forced to review practices and update their advice models; prescriptive character of best interests duty will lead to higher compliance costs**’

- Higher costs will lead to industry-wide consolidation to take advantage of economies of scale; will reduce competition; will allow institutions to charge **higher fees reducing access to advice**
A proper balance between certainty and flexibility?

- Relationship between ASIC Act, Corps Act and ACL where financial products (credit) and advice relating to goods being acquired:
  - “a tangled legislative weave”; a labyrinth of statutes”; a “legislative morass”; a “legal porridge”
- Best interests duty another layer of regulation in a crowded field
- Should we maintain the parallel ASIC Act/ Corps Act and ACL regimes?
- Should we abandon bests interests duty and make financial advisers subject to ACL consumer guarantees?