NEW SOUTH WALES
BAR ASSOCIATION

25 February 2022

Financial Services Legislation
Australian Law Reform Commission
PO Box 12953
George Street Post Shop
Queensland 4003

By email: financial.services@alrc.gov.au

Dear Australian Law Reform Commission

Australian Law Reform Commission Review of the Legislative Framework for Corporations and Financial Services Regulation

1. The New South Wales Bar Association (the **Association**) thanks the Australian Law Reform Commission for the opportunity to make a submission regarding the *Financial Services Legislation: Interim Report A* (Report 137, 2021) (**Interim Report A**), which was tabled in Parliament on 30 November 2021.

2. The Association makes the following submissions directed to aspects of four of the Proposals (A15, A20, A21, A23) and one of the Questions (A24) contained in Interim Report A.

<u>**Proposal A15**</u>

3. This Proposal suggests amending s 766B of the Corporations Act 2001 (Cth) (the Act) to replace the term "general advice" with a term that corresponds intuitively with the substance of the definition.

4. The proposal appears to be based on the principle that defined terms should correspond intuitively with the substance of the definition (Interim Report A at [11.74]). While there is force in that principle, it is submitted that it may not justify a change to the term "general advice" in s 766B for the following reasons:

    a. "general" does fairly capture the scope of the defined term, in that it is a useful shorthand for referring to advice that is not "personal advice" (i.e advice that does not take into account a person's objectives, financial situation or needs);

b. "general advice" has a long history of usage and is presently used by financial services licensees, both to convey to the public the nature of the advice they are giving and to convey to employees the nature of the advice they are permitted to give. The introduction of a new label, which must be used by people who may not be financially sophisticated, has the potential to create confusion;

c. it is significant that the ASIC research conducted in 2021 (summarised in the Interim Report from [11.71]) found no evidence that changing the label would aid consumer understanding;

d. while the proposal advocates no specific alternative, those mentioned, such as "non-personalised recommendation" or "non-tailored recommendation" are not an obvious improvement to the existing label in terms of clarity.

5. While it does not form part of Proposal A15, the suggestion that "personal advice" be changed to "financial advice" (Interim Report in [11.81]) suffers from similar difficulties. The term "personal advice" is embedded in current usage and is a convenient shorthand for the concept it is intended to convey, and the suggested alternative does not seem an obvious improvement to the existing label in terms of clarity.

Proposal A20

6. Relevantly, this Proposal suggests (a) separating the words "efficiently", "honestly" and "fairly" in s 912A(1)(a) into individual paragraphs, and (b) substituting the word "efficiently" with "professionally". Those proposals should not be adopted.

7. As to (a), the change is motivated by a suggested uncertainty as to whether the terms of s 912A(1)(a) impose a composite obligation or a set of standalone obligations (Interim Report A at [13.43]). The suggested uncertainty may be of little practical significance.

8. The Interim Report refers to obiter remarks of Allsop CJ and O'Bryan J in *ASIC v Westpac Securities Administration Ltd* (2019) 272 FCR 170, [2019] FCAFC 187, in which their Honours suggested that the approach of Young J in *Story v National Companies and Securities Commission* (1988) 13 NSWLR 661 (***Story***), of treating the requirement as a "compendious" one, may require revisiting.

9. However, Young J indicated in *Story* that "in the long run it does not seem to me to much matter whether one reads the words cumulatively or disjunctively, because unless a licence holder possesses the three attributes whether as one package or as three separate parcels", there would be a contravention (at 672). While Allsop CJ suggested in *ASIC v Westpac* that he reserved his "views as to the consequences of demonstrating unfairness in the provision of financial services and any need for additional ethical failing"

(at 209, [171]), his Honour did so after recognising that "if a body of deliberate and carefully planned conduct can be characterised as unfair, even if it cannot be described as dishonest, such may suffice for the proper characterisation to be made" (at 209, [170]).

10. The ALRC does not identify cases where treating the requirement as compendious has resulted in behaviour that might otherwise breach the provision being excused. As has been apparent since *Story*, a clear failure to comply with any of the three aspects of the obligation is capable of resulting in non-compliance. However, consideration takes place by reference to the other elements of the provision and in the context of the existing body of case law.

11. A danger in separating the provision into three separate elements is that litigants may argue that the existing case law applying and giving meaning to s 912A(1)(a) has been cast aside,[1] and that the three separate elements should each be given their own sphere of operation. That is significant, because the existing case law requires a certain level of seriousness before s 912A(1)(a) is breached, such as a lack of sound ethical values and judgment or a sufficiently serious departure from reasonable standards of performance.[2] There is room for argument as to whether those constraints will still apply where there is, for instance, an open-ended obligation to act "fairly" which is not tethered to the requirements of honesty and efficiency. Rather than limiting the need for future litigation (as Interim Report [13.67] suggests will occur), the proposed changes may increase it.

12. As to (b), the word "efficiently" has an established meaning in the context of the provision - one which, as the Interim Report notes at [13.63], extends beyond the dictionary meaning of that word and imports considerations of competence and capability. The word "professionally" calls to mind a standard akin to that of reasonable care applicable in the law of negligence, and may encourage arguments that the meaning of the phrase has changed so that the obligation is breached not just by a failure to achieve a basic level of competence but by a failure to act with the care of a skilled professional. Additionally, "professionally" does not necessarily import the notions of the positive obligations of "fairness" and "honestly" which are part of the existing provision.

Proposal A21

13. This Proposal suggests amending s 912A(1)(a) by removing the prescriptive requirements to have in place arrangements for the management of conflicts of interest (s 912A(1)(aa)); to maintain the competence to

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[1] That a legislative change will generally be presumed to change the law was noted by Young J in *Story* at 670; see generally discussion in Paul Latimer, 'Providing financial services "efficiently, honestly and fairly" (2006) 24 *Company and Securities Law Journal* 362, 365.

[2] *ASIC v Westpac Securities Administration Ltd* (2019) 272 FCR 170, [2019] FCAFC 187 at [163], [287].

provide the financial services (s 912A(1)(e)); to ensure representatives are adequately trained (s 912A(1)(f)); and to have adequate risk management systems (s 912A(1)(h)).

14. The premise for the change is that these prescriptive requirements are redundant in the light of the obligation in s 912A(1)(a) to do all things necessary to ensure that the financial services covered by the licence are provided honestly, efficiently and fairly (Interim Report at [13.98]). That premise may not be well founded. As explained in [10] above, the cases establish that to breach s 912A(1)(a) the conduct in question must reach a certain level of seriousness. It is not apparent that the same limitation applies to the prescriptive requirements in question.

15. Further, while there may be areas of overlap with s 912A(1)(a), there is also a benefit in retaining specific prescriptive requirements.

16. Where s 912A(1)(a) contraventions are alleged, the 'things necessary' to have ensured that the conduct did not occur can be formulated in many different ways. Often, while a multitude of internal failures may have contributed to an unfair or dishonest outcome, it will not be necessary to articulate all of those failures in order to prove a contravention of s 912A(1)(a). The outcome may be sufficient to prove noncompliance with s 912A(1)(a). That is not an uncommon scenario because of the high bar set by s 912A(1)(a), being to do all things necessary to ensure compliance.

17. On the other hand, s 912A(1)(aa), (e), (f) and (h) impose specific obligations as to compliance processes and procedures. They help to identify and direct attention to upstream process failures that may otherwise be lost in a general s 912A(1)(a) allegation. That identification, in turn, is useful in communicating to regulated entities, the court and the public at large what are the legislature's expectations as to the fundamental requirements of an entity's internal compliance framework.

18. To illustrate: it may be alleged that a financial services licensee acted unfairly to customers by denying them valuable contractual rights. The regulator may lead evidence that the entity knew the conduct was occurring and failed to stop it. That conduct would be enough to prove a s 912A(1)(a) contravention. It may also be the case that the conduct occurred because sales staff were not trained in customers' contractual rights (which may invoke s 912A(1)(f)), or were rewarded in a conflicted manner (which may invoke s 912A(1)(aa). It may also be the case that the conduct was identified late because the entity's risk management systems were inadequate (which may invoke s 912A(1)(h)). Subsections 912A(1)(aa), (f) and (h) accommodate these alternative approaches.

Proposal A23

19. Proposal A23 suggests consolidating into a single provision proscriptions concerning false or misleading representations and misleading or deceptive conduct currently found in the Act and the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**).

20. This Proposal has much to commend it. The plethora of legislative provisions which currently apply to such conduct, in different ways and with different consequences, makes the law more difficult to understand and more complex and costly to administer than would the case with a well-drafted simplified consolidated provision.

21. However, if the Proposal is pursued, policy decisions will need to be made as to a number of matters:

    a. Remedial consequences. At present, a breach of s 1041H of the Act gives rise to civil liability only; whereas ss 1041E and 1041F give rise to civil penalty and criminal liability as well. A breach of s 12DA of the *ASIC Act* gives rise to civil liability only; whereas ss 12DB, 12DC and 12DF give rise to civil penalty and criminal liability as well. In consolidating the various provisions into one, a decision needs to be made as to whether and, if so, in what circumstances, a contravention of the consolidated provision will give rise to anything more than civil liability.

    b. Proportionate liability. A proportionate liability regime applies to some, but not all, of the existing provisions. There would be much to commend an approach that sees a proportionate liability regime apply to the new consolidated provision. This would stop the 'arbitrage' that currently exists where plaintiffs plead numerous alternative causes of action (including under s 1041E of the *Corporations Act* and s 12DB of the *ASIC Act*) so as to try to avoid the operation of the proportionate liability regimes in s 1041L and following of the *Corporations Act* and s 12GP and following of the *ASIC Act*. This is a common practice in securities class action and in professional negligence actions against auditors and other professionals. Whilst it is understandable that plaintiffs seek to avoid the operation of the proportionate liability regime where they can, their ability to do so (in respect of non-fraudulent conduct where the defendant had no intention to breach the law or inflict harm) may seem at odds with the policy behind the proportionate liability regime. It also adds considerable complexities and costs to the adjudication of claims.

    c. Professional standards schemes. Similarly to the proportionate liability regime, a policy decision will need to be made as to whether the new consolidated provision should be subject to professional standards laws of the States and Territories, for example, should the new provision be subject to provisions like s 1044B of the Act and s 12GNA of the *ASIC Act*.

d. Contributory negligence. There is a question as to whether the new consolidated provision should be subject to a 'contributory negligence' type provision of the kind found in s 1041I(1B) of the Act and s 12GF of the *ASIC Act*.

Question A24

22. Question A24 seeks feedback on whether to recast s 961B(2)(a)-(f) as indicative behaviours of compliance, to which a court must have regard when determining whether the "best interests" obligation in sub-s (1) has been satisfied.

23. This involves a departure from the structure of the present provision, which treats a provider as having complied with the "best interests" obligation in sub-s (1) if the matters in s 961B(2) are satisfied.

24. While the Bar Association takes no position as to whether such a change should be made, the change may have a more substantive operation than the ALRC might intend.

25. Case law indicates that the obligation imposed by s 961B is concerned with the process or procedure involved in providing advice to a client.[3] This is evident in the steps set out in s 961B(2) which include the identification of certain matters, the making of reasonable enquiries, the assessment of the provider's expertise, and the conduct of reasonable investigation into financial products. Each of those procedural steps is no doubt intended to ensure that the resulting advice is, in fact, advice in the best interests of the client. However, the focus of the 'best interests' obligation is ultimately the provider's conduct, rather than the advice that is ultimately given.[4] If the provider has taken each relevant step in s 961B(2), he or she will have satisfied the obligation under s 961B irrespective of the advice given.

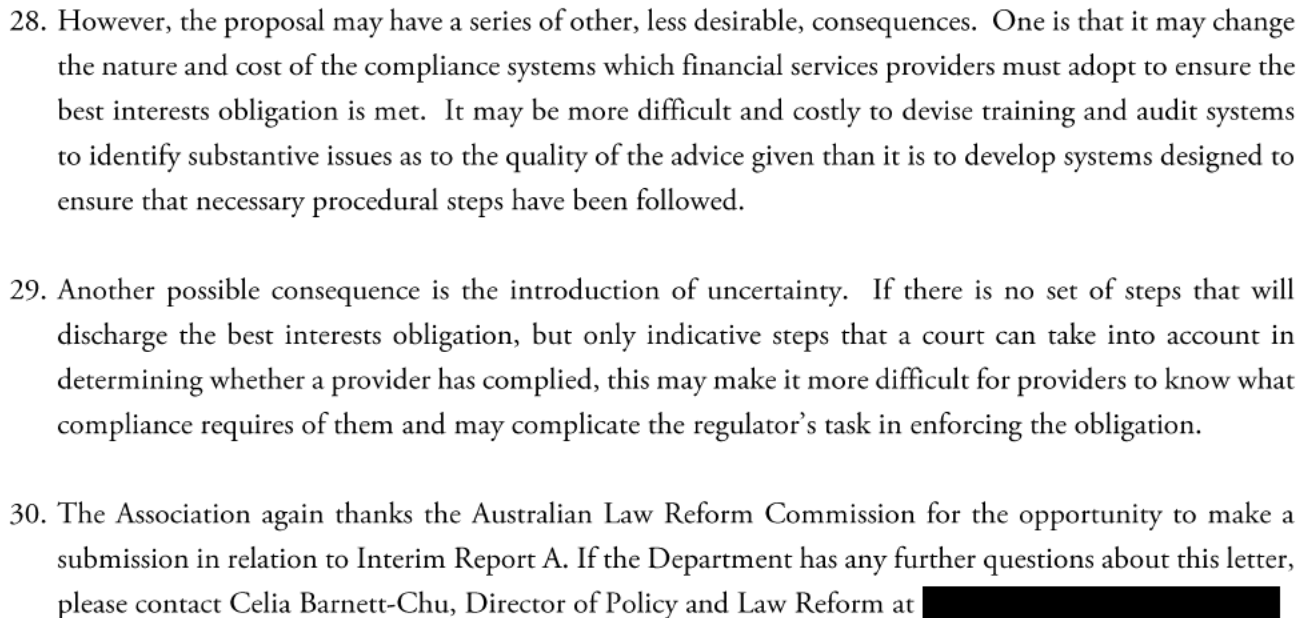
26. If the "best interests" obligation is re-cast from a safe harbour to a set of indicative behaviours, this may re-direct providers' and the regulator's attention from the process or procedure that the provider followed, to focus instead or in addition on the substance of the advice given.

27. That may result in positive outcomes for clients by encouraging providers to focus on actually acting in the best interests of their clients rather than ticking boxes and proceeding to provide advice of variable quality. Restructuring the provision may also make it easier for clients, who have suffered loss as a result

[3] *ASIC v NSG Services Pty Ltd* (2017) 122 ACSR 47 at 53; [2017] FCA 345 at [21]; *ASIC v Westpac Banking Corporation* [2019] FCA 2147 at [14]; *ASIC v Westpac* (2019) 272 FCR 170 at 206, 240, 263-264; [2019] FCAFC 187 at [151], [301], [404]-[409].

[4] *ASIC v Financial Circle* (2018) 131 ACSR 484 at 509; [2018] FCA 1644 at [129].

of poor advice, to obtain redress if it is sufficient for them to prove the advice provided was plainly not in their best interests and that ought to have been reasonably apparent to the provider having regard to the client's relevant circumstances.

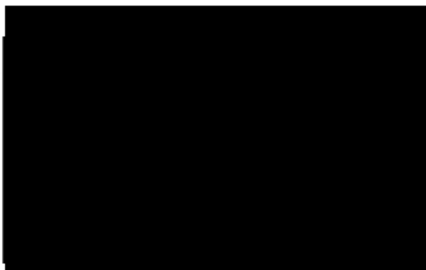


28. However, the proposal may have a series of other, less desirable, consequences. One is that it may change the nature and cost of the compliance systems which financial services providers must adopt to ensure the best interests obligation is met. It may be more difficult and costly to devise training and audit systems to identify substantive issues as to the quality of the advice given than it is to develop systems designed to ensure that necessary procedural steps have been followed.

29. Another possible consequence is the introduction of uncertainty. If there is no set of steps that will discharge the best interests obligation, but only indicative steps that a court can take into account in determining whether a provider has complied, this may make it more difficult for providers to know what compliance requires of them and may complicate the regulator's task in enforcing the obligation.

30. The Association again thanks the Australian Law Reform Commission for the opportunity to make a submission in relation to Interim Report A. If the Department has any further questions about this letter, please contact Celia Barnett-Chu, Director of Policy and Law Reform at

Yours sincerely



Michael McHugh SC
President