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Financial Services Newsletter

2021 . Vol 20 No 1

Contents

Information contained in this newsletter is current as at March 2021

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General Editor's note

***Karen Lee** LEGAL KNOW-HOW*

In this issue of the *Financial Services Newsletter*, I have four articles which financial services lawyers will find interesting and relevant. Let me tell you a little about them.

On 3 February 2021, the High Court of Australia upheld the Full Federal Court's decision and confirmed that Westpac Bank subsidiaries, Westpac Securities Administration Ltd and BT Funds Management Ltd, breached financial services laws, including the requirement to act in their clients' best interests and the requirement to act honestly, efficiently and fairly. This case has important ramifications for the characterisation of, and distinction between, general and personal financial product advice. In "Westpac gets too personal with financial advice", editorial board member **Andrea Beatty** and **Gabor Papdi** (Piper Alderman) take us through the facts of the case, and then explain the practical relevance of the decision.

The next article is by editorial board member **Jon Ireland**, **Stephen Putnins** and **Angus Jamieson** (Norton Rose Fulbright Australia), titled "Trends in 'ESG regulation' and the industry response — an Australian investment funds perspective". ESG stands for "environmental, social and governance". In this article, the authors consider Australia's financial services and prudential regulators' current approach to "ESG regulation" in the context of managed funds and superannuation industries. They also consider the proposed developments in this space, and the industry response.

In 2021, one of the Financial Services Royal Commission reform coming down the pipeline is the introduction of breach reporting obligations for credit licensees. The breach reporting regime for financial services licensees also faces a revamp. The time to understand the reform is now, as the new regime will commence on 1 October 2021. In their article "Into the breach for the financial services industry", **Matthew Farnsworth** and **Amanda Khoo** (Mills Oakley) share their insights, including what licensees need to do to keep up with this new regime.

In November 2020, the judgment of the NSW Supreme Court in *DH Flinders Pty Ltd v Australian Financial Complaints Authority* was handed down. This decision related to AFCA's jurisdiction to consider a complaint against a licensee in relation to the conduct of its corporate authorised representative, specifically where the conduct of the representative was without or outside authority. Following this decision, AFCA amended its Rules to provide clarity for consumers and financial firms regarding AFCA's jurisdiction to receive complaints about the conduct of an authorised representative of an AFCA member. What was this case about and what are the key implications of the findings in this case? You will find the answer in "AFCA's powers successfully challenged in the Supreme Court of New South Wales: when a representative has no authority, AFCA has no power" by editorial board member **Andrea Beatty**, **Simon Morris** and **Chelsea Payne** (Piper Alderman).

I hope you will enjoy reading these articles.

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Karen Lee is the General Editor of the Australian Banking & Finance Law Bulletin and the Financial Services Newsletter. She also partners with LexisNexis in other capacities, including as Specialist Editor for precedents in banking and finance, mortgages and options, and as contributing author of a number of other publications, including Australian Corporation Finance Law, Halsbury's Laws of Australia and Practical Guidance General Counsel. Karen established her legal consulting practice, Legal Know-How, in 2012. She provides expert advice to firms and businesses on risk management, legal and business process improvement, legal documentation, regulatory compliance and knowledge management. Prior to this, Karen worked extensively in-house, including as Head of Legal for a leading Australasian non-bank lender, as well as in top-tier private practice, including as Counsel at Allen & Overy and Clayton Utz.

Westpac gets too personal with financial advice

Andrea Beatty *and* ***Gabor Papdi*** *PIPER ALDERMAN*

The Australian High Court has given guidance on the boundary between general advice and personal advice. On 3 February 2021, the High Court unanimously dismissed an appeal[1] brought by two Westpac subsidiaries[2] against the Full Federal Court's decision that they had provided personal financial product advice not authorised by their Australian financial services licences (AFSLs) in marketing superannuation consolidation to their customers. The decision highlights that financial product providers must exercise caution when marketing their products to customers.

Background

The case concerned a marketing drive in which the Westpac subsidiaries sought to increase funds under management by having existing Westpac superannuation customers (under the "BT" brand) consolidate all of their superannuation funds into a single Westpac superannuation account. The Westpac subsidiaries wrote to their customers offering to search for non-Westpac superannuation accounts that the customers had and to roll over such accounts into their Westpac superannuation accounts. Customers who responded and who had non-Westpac accounts received at least one telephone call from a Westpac group employee (acting as an agent of the appellant Westpac subsidiaries). In those calls, the customer was given a general advice warning at the outset but was then asked about what they saw as the main benefits of consolidating their superannuation accounts. The Westpac employee would use "social proofing" language in which they would reinforce to the customer that the customer's objectives or views were commonly held. Each call ultimately involved the Westpac employee offering to help the customer consolidate their superannuation in their Westpac account.

The Westpac subsidiaries were not authorised under their AFSLs to provide personal advice about superannuation to retail clients. The Westpac subsidiaries also acted on the belief that the calls did not involve the provision of personal advice and therefore did not provide statements of advice to customers or act in a way that might discharge the statutory best interests duty.

Issues

Unlike at first instance and in the Full Federal Court, the Westpac subsidiaries in the High Court conceded that the calls in question involved the provision of financial product advice. At issue was whether that advice was personal advice (as held by the Full Federal Court) or general advice (as held by the trial judge). Ultimately this case turned on whether a reasonable person in the position of each customer might expect the Westpac subsidiaries to have in fact considered one or more of the customer's objectives, financial situation and needs.[3]

The finding at first instance and on appeal that Westpac breached its general obligation under s 912A(1)(a) of the Corporations Act 2001 (Cth) to "do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly" were not challenged in this appeal.

Outcome

The High Court unanimously dismissed the appeal, holding that the Westpac subsidiaries provided personal advice to customers in the telephone calls.

The majority held the following:

- The general advice warning at the beginning of each call did not in the circumstances prevent a reasonable customer from expecting the caller to consider the customer's objectives, since immediately after the warning the caller would ask the customer about their objectives in relation to superannuation and then use social proofing techniques to assure the customer of the validity of their stated objectives.[4]
- The advice that was free of charge to the customer was at most neutral to the reasonable customer's expectations, as the customers had already paid fees to the Westpac subsidiaries for financial services in relation to superannuation and a reasonable person would see the benefit to the Westpac subsidiaries in the form of future fees if the advice were acted on.[5]
- The callers at times revealing a lack of comprehensive knowledge about the customer's financial affairs was not inconsistent with an expectation

that the customer's objectives were taken into account. The social proofing techniques affirming the customer's stated objectives created a reasonable expectation that the superannuation rollover service would achieve those objectives.[6]

- Advice can be based on a customer's objectives even if those objectives are highly generic and almost universally held (such as to minimise fees).[7]
- The nature of Westpac's business and its experience in financial services means that each customer might reasonably have believed that the Westpac subsidiaries took into account the customer's stated objectives in recommending the superannuation rollover service.[8]
- "Considered" in s 766B(3) does not require an active and comprehensive process of evaluation and reflection. In that context, it simply means "took account of".[9]
- The statutory definition of personal advice does not require the totality of a person's objectives, financial situation and needs to be taken into account. It is sufficient if there is consideration of at least one aspect of the person's objectives, financial situation or needs.[10]

Gordon J reached the same conclusion as the majority for the following reasons:

- Section 766B(3)(b) contains an objective test based on the reasonably possible expectations of a reasonable person in the customer's position at the time of receiving the advice.[11]
- "Considered" in s 766B(3) has its ordinary meaning.[12]
- Having regard to the text, context and purpose of s 766B and Ch 7 of the Corporations Act more broadly, advice is personal advice if the adviser considers at least an aspect of one of the customer's objectives, financial situation or needs, or the customer might reasonably apprehend them to have done so.[13]
- There was a pre-existing trustee–beneficiary relationship between the Westpac subsidiaries and each customer, which a reasonable person might expect to result in the Westpac subsidiaries acting in the customers' best interests, including by considering one or more of their objectives, financial situation or needs in giving financial product advice.[14]
- Customers were asked about their objectives, which were reinforced to the customer through the social proofing techniques, and the tenor of the calls was about helping the customer, meaning that a reasonable person in each customer's position might expect the adviser to have considered their objectives.[15]
- Gordon J reasoned very similarly to the majority in relation to the circumstances that a general advice warning was given to the customer, the advice was free of charge to the customer and the caller revealed a lack of knowledge about the customer's financial situation.[16]

Practical relevance of the decision

The decision has value in clarifying the boundaries between general advice and personal advice. It also highlights the need to exercise caution when marketing financial products to ensure that personal advice is not unintentionally given to customers. This is important not only to AFS licensees who lack personal advice authorisation but also to licensees marketing products to retail clients within the scope of their authorisation. This is because personal advice to retail clients carries additional obligations around giving written statements of advice, acting in clients' best interests and in relation to the kinds of remuneration permitted.

Given the breadth of the definition of "financial product advice", marketing or promotion of a product may well result in financial product advice being given. However, personal advice attracts additional obligations, including the need to give a written statement of advice and to act in the client's best interests in relation to the advice. These obligations add friction to the marketing process and are not practical to comply within the context of marketing by a financial product provider. Undirected marketing in the media is less likely to be affected in comparison to one-on-one marketing conversations.

Another takeaway for financial service providers from this decision is that the hypothetical reasonable person has high expectations for the conduct of financial services providers. That the recommended course of action — to consolidate externally held superannuation in a Westpac account — was obviously in the Westpac subsidiaries' self-interest did not prevent the court from finding that a reasonable person in each customer's position might have expected the Westpac subsidiaries to have taken account of the customer's objectives, financial situation and/or needs when giving the advice. That the advice was free of charge also did not turn the case in the Westpac subsidiaries' favour. This theme that it is reasonable for a person to expect their bank or superannuation trustee to prioritise customers' interests over their own interests is expected to continue in future across financial services generally.

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Footnotes

1. *Westpac Securities Administration Ltd v Australian Securities and Investments Commission (ASIC)* [2021] HCA 3; BC202100401.
2. Westpac Securities Administration Ltd and BT Funds Management Ltd.
3. Corporations Act 2001 (Cth), s 766B(3)(b); above n 1, at [3].
4. Above n 1, at [8].
5. Above n 1, at [9].
6. Above n 1, at [10].
7. Above n 1, at [11].
8. Above n 1, at [13].
9. Above n 1, at [14]–[18].
10. Above n 1, at [20].
11. Above n 1, at [57]–[58].
12. Above n 1, at [59]–[60].
13. Above n 1, at [61]–[67].
14. Above n 1, at [74].
15. Above n 1, at [75]–[77].
16. Above n 1, at [78]–[80].

Trends in "ESG regulation" and the industry response — an Australian investment funds perspective

***Jon Ireland**, **Stephen Putnins** and **Angus Jamieson** NORTON ROSE FULBRIGHT AUSTRALIA*

In recent years, Australia's financial services and prudential regulators have responded to the shift in perspective across industry to align their regulatory frameworks with those in other developed economies who are leading the way in recognising the importance of environmental, social and governance (ESG) factors. This article considers the current approach to "ESG regulation" in the context of Australia's managed funds and superannuation industries, proposed developments in this space, and the industry response.

ESG regulation in Australia

Australia's approach to ESG regulation, as it applies to asset managers and superannuation trustees, is primarily focused on the enhancement of product disclosures and the acknowledgment of ESG risks and opportunities. Over the past 5 years, the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) have carried out coordinated efforts, supported by the Council of Financial Regulators to ensure regulated entities are actively seeking to understand and manage the financial risks which may be posed by ESG factors, as they would for other economic and operational risks.[1] We have outlined the current regulatory approach below.

APRA

In its latest *Policy Priorities* Information Paper, APRA announced plans to increase industry resilience through guidance, vulnerability assessments and increased supervisory attention, with a view to assisting entities in developing frameworks for the assessment and monitoring of climate-related financial risks.[2] This guidance is expected to be released in the first half of 2021, in the form of an update to *Prudential Practice Guide SPG 530 — Investment Governance* (SPG 530) which currently assists registrable superannuation entity (RSE) licensees in complying with requirements in relation to the formulation and implementation of their investment strategies.[3] The release of this guidance will be a significant development in ESG regulation in the superannuation industry and will be the result of a lengthy period of industry consultation.[4]

At present, APRA's guidance in SPG 530 states that an RSE licensee may take into account ESG factors when formulating an investment strategy which may result in in an RSE licensee offering an "ethical" investment option to serve the best interests of its beneficiaries.[5] We expect that this guidance will be further expanded to consider the interaction between ESG factors and the fiduciary obligations of the RSE licensee. In the meantime, APRA continues to encourage the adoption of voluntary frameworks to assist entities with assessing, managing and disclosing their financial risks associated with climate change, such as the Financial Stability Board's Task Force on Climate-Related Financial Disclosures (TCFD) recommendations.[6]

ASIC

At present, issuers distributing products (for example, managed funds or superannuation products) to Australian retail clients must include mandatory disclosures within their product disclosure statements (PDSs) which detail the extent to which labour standards or environmental, social or ethical considerations are taken into account in the selection, retention or realisation of the investment.[7] Notably, where such considerations are not taken into account by the product issuer, the PDS must explicitly state this.[8]

In connection with these disclosures, it is foreseeable that the growing acknowledgment that ESG factors impose a material financial risk in relation to financial products will encourage asset managers and superannuation trustees to more frequently include reference to "climate change risk" within the "significant risks" PDS disclosures.[9] ASIC has contributed to investor pressures in this respect, updating its regulatory guidance in 2019, so that listed entities which are required by law to carry out mandatory "operating and financial reviews" must include discussion of environmental, social and governance risks where those risks could affect the entity's achievement of its financial performance.[10] Directors who are subject to such reviews are also encouraged by ASIC to consider whether it would be worthwhile to

disclose additional information that would be relevant under integrated reporting, sustainability reporting or the recommendations of the TCFD.[11]

Industry response

The asset management industry in Australia to an extent historically had to account for compliance with ESG regulation in meeting client demands. As appears to be the case with other jurisdictions, firms within the Australian managed funds and superannuation industry have sought to ensure that they reflect the expectations of their clients, shareholders and colleagues who are increasingly concerned about ESG factors. As an example of the measures taken by superannuation trustees, approximately 20% of superfunds have targets, or have expressed an aspiration, to achieve net zero emissions by 2050 for their investment portfolios, of which three major RSE licensees have committed to achieve net zero by 2050 across their entire portfolios.[12] Noting that RSE licensees are significant allocators of capital in Australia, this movement could well play a part in encouraging additional asset managers to sign up to the United Nations-backed Principles for Responsible Investment (PRI).[13]

Studies completed in 2019 suggest that asset managers are increasingly implementing responsible investment policies and making these publicly available to their clients.[14] The purpose of such policies is generally to outline the manager's approach to:

- managing extra-financial factors in the valuation of assets and allocation of capital;
- exercising its fiduciary duty as stewards of capital (including voting over all relevant holdings and disclosing these publicly);
- its role in working with other members of the investment community in delivering a more stable financial and economic system; and
- avoiding harm, benefiting stakeholders and contributing to solutions through its engagement with investee management and allocation of capital towards sustainable assets and enterprises.[15]

Through the implementation of these responsible investment policies, studies suggest that asset managers are providing greater transparency in the disclosure of their holdings.[16] The spectrum of responsible and ethical investment strategies has also broadened beyond negative screening investment options to include responsible investment practices such as ESG integration, corporate engagement and impact investing, whereby investments are made with the intention of generating positive social and/or environmental impact alongside financial returns.[17] Further, and from an assets under management (AUM) perspective, studies completed in 2019 suggest that over 37% of total AUM in the Australian market are managed by asset managers who apply a leading approach to their responsible investment processes and disclosures.[18] We expect the shift to continue on its current trajectory as Australian regulators further develop their regulatory frameworks.

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Footnotes

1. APRA, Understanding and managing the financial risks of climate change, 24 February 2020, www.apra.gov.au/understanding-and-managing-financial-risks-of-climate-change.
2. APRA *APRA's Policy Priorities* Information Paper (February 2021) www.apra.gov.au/sites/default/files/2021-01/Information%20Paper%20-%20Policy%20Priorities%202021.pdf; APRA "Letter: Understanding and managing the financial risks of climate change" (24 February 2020) www.apra.gov.au/sites/default/files/2020-02/Understanding%20and%20managing%20the%20financial%20risks%20of%20climate%20change.pdf.
3. *APRA's Policy Priorities*, above, at 15; APRA *Prudential Practice Guide SPG 530 — Investment Governance* (November 2013) www.apra.gov.au/sites/default/files/prudential-practice-guide-spg-530-investment-governance.pdf (SPG 530).
4. Above n 1.
5. SPG 530, above n 3, at para 34.
6. Above n 1.
7. Corporations Act 2001 (Cth), s 1013DA; ASIC *Regulatory Guide 65 Section 1013DA disclosure guidelines* (30 November 2011); Corporations Regulations 2001 (Cth), Sch 10D cl 7(9)(c) and Sch 10E cl 7(7)(c).
8. Corporations Regulations, r 7.9.14C.
9. Corporations Regulations, Sch 10E cl 6(2); Corporations Act, s 1013D(1)(c); ASIC *Regulatory Guide 168 Disclosure: Product Disclosure Statements (ando other disclosure obligations)* (October 2011) at RG 168.91.

10. ASIC *Regulatory Guide 247 Effective disclosure in an operating and financial review* (August 2019) at RG 247.64–247.66.
11. Above, at RG 247.66; also see ASIC *Climate risk disclosure by Australia's listed companies* Report 593 (September 2018) https://download.asic.gov.au/media/4871341/rep593-published-20-september-2018.pdf.
12. Monash University and ClimateWorks Australia, Net Zero Momentum Tracker — Superannuation Sector, September 2020, www.climateworksaustralia.org/resource/net-zero-momentum-tracker-superannuation-sector.
13. Principles for Responsible Investment www.unpri.org/.
14. Responsible Investment Association Australasia *Responsible Investment Benchmark Report 2020 Australia* (September 2020) at 9 https://responsibleinvestment.org/wp-content/uploads/2020/09/RIAA-RI-Benchmark-Report-Australia-2020.pdf.
15. Above, at 19.
16. Above.
17. Above n 14, at 14.
18. Above n 14, at 7.

Into the breach for the financial services industry

Matthew Farnsworth *and* ***Amanda Khoo*** *MILLS OAKLEY*

Following the unearthing of issues inherent within the financial services industry by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission), the government and regulators are now playing catch up to correct the failings that the Royal Commission's final report highlighted across the financial services sector.

As part of the government's push with its unprecedented legislative program (being the Financial Sector Reform (Hayne Royal Commission Response) Act 2020 (Act)) to give effect to many of the Royal Commission's many recommendations, s 912D of the Corporations Act 2001 (Cth) (the Corporations Act), which governs breach reporting for Australian financial services (AFS) licensees, faces a revamp that will result in significant implications for AFS licensees. The Act also introduces a comparable regime for Australian credit licensees under the National Consumer Credit Protection Act 2009 (Cth), resulting in the first ever breach reporting regime in consumer credit. This new breach reporting regime will commence on 1 October 2021.

A wave of changes

Under the existing breach reporting regime, an AFS licensee must report to Australian Securities and Investments Commission (ASIC) as soon as practicable and in any event within 10 business days of becoming aware of a significant breach (or likely significant breach) of certain obligations. Concerns with this regime mainly centred around the significance test, which requires an AFS licensee to consider various factors.

Perhaps one of the most noteworthy changes under the new regime is the expansion of the "significance" test to require reporting in a wider range of circumstances. This is explored further below.

Under the new legislation, the reporting obligation applies when the licensee "knows" that there has been or will be a significant breach and also where the licensee knows that there are *reasonable grounds* to believe that it is the case, or is *reckless* as to whether there are reasonable grounds to believe that it is the case.

Additionally, the reporting obligation now extends to the investigation stage as well if the investigation has continued for more than 30 days, and a report is also required on the outcome of such investigations. Unfortunately, the Act and the Explanatory Memorandum for the bill do not provide a definition of "investigation", which is likely to cause a number of issues for licensees as each licensee may have different investigation processes. The exact trigger for when an investigation into a reportable breach begins will likely differ across the board.

There is also a new requirement to notify clients of reportable breaches involving personal advice to retail clients or credit assistance by mortgage brokers. Licensees also have to investigate and quantify any loss or damage suffered and compensate the affected clients under this requirement.

Controversially, the Act introduces a "dobbing in" obligation for licensees to lodge reports in relation to other licensees. AFS licensees and credit licensees must lodge a report with ASIC within 30 calendar days after the licensee first reasonably knows that there are reasonable grounds to suspect that a reportable situation has arisen about mortgage brokers or individual financial advisers.

In March 2020, ASIC had sought to standardise the content and method of reporting by stating in their updated RG78 that AFS licensees "must report to us through the ASIC Regulatory Portal".[1] This has now been affirmed through the Act, with licensees being required to answer targeted questions through the ASIC Regulatory Portal regarding breaches for ASIC's analysis.

In the new regime, ASIC must also publish information on its website regarding breach reports lodged with ASIC and Australian Prudential Regulation Authority during the financial year.

Significant breach

As a reprieve to the more onerous obligations imposed by the new regime, the timeframe for reports to be lodged has been extended, going from 10 days to 30 days after the licensee has reasonable grounds to believe that a reportable situation has arisen.

A reportable situation occurs when:

(a) a licensee or its representative has breached a core obligation and the breach is significant
(b) the licensee or its representative is unable to comply with a core obligation and the breach, if it occurs, will be significant
(c) the licensee or its representative has commenced an investigation into whether (a) or (b) applies and the investigation has continued for more than 30 days
(d) an investigation described in (c) above discloses that there is no reportable situation of the kind mentioned in (a) or (b) or
(e) in the course of providing a financial service or engaging in a credit activity (as applicable), the licensee or its representative has engaged in gross negligence or serious fraud. (Interestingly, "gross negligence" is not defined or addressed in the Explanatory Memorandum. Its common law definition will apply, meaning an extreme degree of carelessness or recklessness. "Serious fraud" is defined in s 9 of the Corporations Act as an offence involving fraud or dishonesty, against any law, that is punishable by imprisonment for a period of at least 3 months)

"Core obligation" is a new term introduced as part of the regime and is defined in the Act. They are the same provisions that fall under the current breach reporting regime.

A breach of a core obligation is deemed to be significant if:

- the provision breached is an offence that may involve imprisonment for certain maximum periods
- the provision breached is a civil penalty provision or (for AFS licensees) s 1041H(1) of the Corporations Act or s 12DA(1) of the Australian Securities and Investments Commission Act 2001 (Cth) (misleading or deceptive conduct in relation to a financial product or service) or
- the breach results or is likely to result in material loss or damage to clients or members

For credit licensees, the breach of a "key requirement" under the National Credit Code is also considered significant.

In addition to all of the above, licensees must still comply with the significance test in the current regime, taking into account the number or frequency of similar breaches, the impact of the breach on the licensee's ability to provide the services covered by its license, the extent to which the breach indicates the licensee's compliance arrangements are inadequate, and any other matters required by regulation.

Registered managed investment schemes

The new regime streamlines breach reporting obligations for responsible entities. Currently, under s 601FC(1)(l) of the Corporations Act, the responsible entity of a registered scheme must report to ASIC any breach of the Corporations Act that relates to the scheme and that has had, or is likely to have, a materially adverse effect on the interests of members, as soon as practicable after it becomes aware of the breach. This reporting requirement will be replaced by the new breach reporting regime. The core obligations captured by the new regime cover key breaches relating to registered schemes, namely Ch 5C of the Corporations Act.

What next?

As there are now many more circumstances under which breach reports will be required as a result of the expansion of the significance test (particularly as a number of financial services laws are core obligations), it is expected that the number of breach reports received by ASIC will increase dramatically. The Explanatory Memorandum has highlighted that the new legislation may be revisited and updated by regulation after being rolled out, particularly if there are largely unproblematic breach reports that would not otherwise be significant, to relieve any additional unnecessary regulatory burden on both the government and licensees. The government may, further down the line, set a threshold for financial loss to customers as a part of the breach reporting regime to curb this issue, or only require reporting when investigations result in breaches, as opposed to every instance of investigation.

That being said, as new civil penalty provisions which carry significant financial penalties have also been introduced as part of the regime, it is important for licensees to understand these new reporting requirements and ensure that they have established systems and controls to comply.

The recommended updates for licensees to keep up with this new regime include the following:

- Finetuning breach assessment processes, taking into account that the test now includes "reasonable grounds" and "recklessness".
- Updating compliance procedures and internal processes to ensure that the new deadlines under this regime are met. Procedures will be needed to identify when an investigation into a reportable breach begins, thus triggering the 30-day timeframe for reporting. There is also an added incentive for licensees to instigate and resolve investigations within 30 days where possible to avoid the need for double reporting.

- Creating systems and processes to ensure that they are able to comply with the requirement to notify clients affected by reportable situations and remediate the situation if required.
- Establishing systems to identify reportable situations involving other licensees and comply with their obligations to report these situations to ASIC.

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Footnotes

1. Australian Securities & Investments Commission *Regulatory Guide 78: Breach reporting by AFS licensees* (March 2020), https://download.asic.gov.au/media/5529238/rg78-published-30-march-2020.pdf.

Financial Planning in Australia: Advice and Wealth Management
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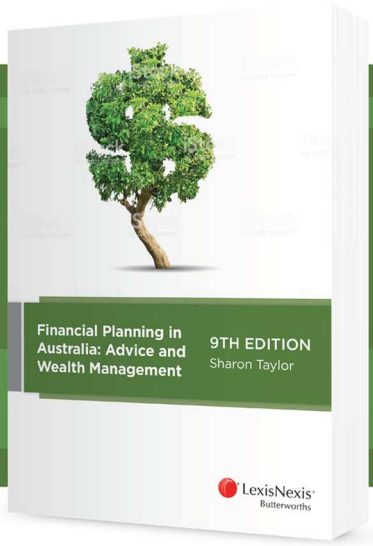

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Features

- Considers recent changes to the law, including the Financial Adviser Standards and Ethics Authority (FASEA) Code of Ethics that becomes mandatory from January 2020
- In light of tighter regulation arising from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, introduces a new chapter on Ethics and Professionalism that explores conflict of interest dilemmas for advising professionals
- Gives substantial treatment to behavioural finance to cover the FASEA requirements in this area

About the Author

Sharon Taylor is an Associate Professor in Accounting and Financial Planning at Western Sydney University (WSU). She held the role of convenor of the Financial Services Discipline Team for many years and was Chair of the committee developing both the Master of Commerce (Financial Planning) and Bachelor of Financial Advising degree programs at WSU. A Fellow of CPA Australia and a Registered Tax Agent, Sharon has also worked previously at the Australian Taxation Office. She was a Foundation Fellow of the Association of Financial Educators. Currently she is a member of the Financial Planning Academic Forum and is Chair of the Financial Planning Education Council.

Table of Contents

Publication Date: December 2019

ISBN: 9780409351422 (softcover)
RRP * incl. GST: $160.00

ISBN: 9780409351439 (eBook)
RRP * incl. GST: $160.00

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AFCA's powers successfully challenged in the Supreme Court of New South Wales: when a representative has no authority, AFCA has no power

***Andrea Beatty**, **Simon Morris** and **Chelsea Payne** PIPER ALDERMAN*

On 26 November 2020, in the matter of *D H Flinders Pty Ltd v Australian Financial Complaints Authority Ltd*[1] Stevenson J of the New South Wales Supreme Court ruled that Australian Financial Complaints Authority (AFCA) only has the contractual authority to deal with complaints against Australian financial services (AFS) licensees regarding the conduct of an authorised representative if that representative was acting within the scope of their authority.

Prior to the ruling AFCA (and before it Financial Ombudsman Service (FOS)) has asserted power to determine complaints brought against Financial Firms in relation to the unauthorised conduct of representatives on the basis that concepts of attribution of liability in ss 917A and 917B of the Corporations Act 2001 (Cth) were relevant to AFCA's powers.

In a quick response and in an attempt to circumvent the impact of the decision, Australian Securities and Investments Commission (ASIC) by legislative instrument amended AFCA's Rules. The stated intention of the change to AFCA's Rules is to expand AFCA's ability to determine complaints arising from the conduct of representatives, irrespective of the representative's authority. The new Rules apply to complaints lodged after 13 January 2021.

Facts

D H Flinders, a corporate trustee, challenged the contractual authority of AFCA, the largest external dispute resolution scheme in Australia to determine complaints brought against it by investors in a home loan product issued by EFSOL Pty Ltd (in liquidation). D H Flinders also argued that the manner in which AFCA conducted the complaints-handing process breached its contractual obligation of procedural fairness and impartiality.

EFSOL was a Corporate Authorised Representative operating under D H Flinders' AFS licence, however, EFSOL's authority did not extend to the home loan product. Despite the absence of any authority or a customer relationship with D H Flinders, AFCA asserted that by reason alone of EFSOL being an Authorised Representative of D H Flinders, AFCA had the power to determine complaints brought against D H Flinders relating to any EFSOL conduct.

Decision

D H Flinders had contended that because EFSOL's conduct was unauthorised AFCA had no power under its Rules to determine complaints brought against it. AFCA argued that because a licensee may be found liable for the unauthorised conduct of its Authorised Representative pursuant to s 917B of the Corporations Act, it had the power and authority to determine the complaints. Stevenson J agreed with D H Flinders holding that, in the absence of a customer relationship or the Authorised Representative acting within its usual or ostensible authority "AFCA has no contractual authority, jurisdiction or power to determine the complaints."[2]

In light of ASIC's hasty post judgment intervention to circumvent the restraints imposed on AFCA's powers, it may be Stevenson J's findings about AFCA's lack of impartiality and the failure to provide procedural fairness that will have the greater impact on the future conduct of AFCA's processes.

Under AFCA's Rules they have a right to assist complainants when they submit a complaint. However, in the D H Flinders EFSOL Related Complaints the complaints were only submitted after an AFCA legal officer had contacted the complainants, told them of D H Flinders' existence, advised them about the basis for D H Flinders to be found liable and encouraged them to make a claim.[3] Stevenson J observed that AFCA's conduct stepped beyond AFCA's legitimate function of assisting complainants and amounted to AFCA entering the fray in contravention of its contractual obligation of

procedural fairness, impartiality and fairness.[4] Stevenson J reasoned that under AFCA's Rules it could not, consistent with its obligations to be impartial, act both as an advisor and a decision maker.

It will be interesting to see whether in its future dealings with complainants AFCA is more restrained and adopts a less sympathetic tone in the assistance it provides.

New Rules

On 13 January 2021, AFCA published new approved Rules and supplementary Operational Guidelines to amend the Rules and definitions for "financial firm" and "representative". These new Rules incorporating the updated definitions are applicable to complaints lodged from 13 January 2021. When promulgating these new Rules, AFCA stated that the amendments means that a complaint can be made against a Financial Firm concerning any "employee, agent or contract of the Financial Firm" regardless of whether representative's conduct is "within or without authority". If this is actually the effect of the change then it expands the scope and applicability of being a representative and forgoes any "actual, ostensible, apparent or usual" authority required prior to the new Rules. AFCA commented that this had been done to "provide clarity . . . regarding AFCA's jurisdiction to receive complaints about the conduct of an authorised representative of an AFCA member".[5]

The amended Rules purport to expand AFCA's jurisdiction and in turn increase the liability of licensees. Given that it is a requirement of credit and financial service licence holders to be a member of AFCA as a condition of their license, some may reconsider the appointment of their credit and authorised representatives, given the potential for liability for acts done outside of their contractual authority.

As noted, the new Rules operate in relation to complaints lodged from 13 January 2021. In respect of complaints made under the previous Rules that are captured by the logic of Stevenson J's reasons, AFCA in its media release encouraged the financial firms involved to consent to AFCA considering the complaint to achieve an early resolution and avoid the prospect of potential court or other action by the complainant.[6]

As a matter of law if AFCA lacks the contractual right to determine a complaint its power cannot be actualised by agreement. As a matter of practicality, irrespective of future litigation risk, it is hard to imagine what possible motivation an AFS license holder could have to submit itself voluntarily to the exercise of AFCA's discretion.

Key takeaways

The key implications of the findings in this case are as follows:

- Subject to the effectiveness of the new Rules, persons with complaints about the unauthorised conduct of employees and representatives of AFSL holders, may only attribute liability to the AFS license holder under s 917B in a court and not through AFCA.
- AFCA should be careful when communicating with claimants about the claims they are pursuing to ensure they do not infringe the requirement to provide its services in an independent, impartial, fair and procedurally fair manner in accordance with AFCA's requirements.

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Footnotes

1. *D H Flinders Pty Ltd v Australian Financial Complaints Authority Ltd* [2020] NSWSC 1690; BC202011698.
2. Above, at [89].
3. Above n 1, at [128].
4. Above n 1, at [135].
5. Australian Financial Complaints Authority "AFCA Rules change following ASIC direction" media release (21 January 2021) www.afca.org.au/news/media-releases/afca-rules-change-following-asic-direction.
6. Above.

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Cite this issue as (2021) 20(1) *FSN*
SUBSCRIPTION INCLUDES: 10 issues per volume plus binder www.lexisnexis.com.au
SYDNEY OFFICE: Locked Bag 2222, Chatswood Delivery Centre NSW 2067
CUSTOMER RELATIONS: 1800 772 772
GENERAL ENQUIRIES: (02) 9422 2222
ISSN: 1035-2155 Print Post Approved PP 25500300764