Hamilton Blackstone
LAWYERS

QAR, "Good Advice" and the "Statutory Best Interests Duty": Handle with care

Financial Services *Reform*.

Future of Financial Advice.

FASEA Code of *Ethics*.

Quality of Advice Review.

The pattern continues. First, the industry needed statutory reform. Then further reform was needed because advisers allegedly caused the heavy losses sustained by superannuitants and retirees during the GFC. But even more was needed, because advisers weren't bound by a code of ethics.

By intent or design, it was established that advisers weren't adequately regulated and couldn't be trusted, so we put it in someone else's hands to determine whether or not the advice they were giving was in their own clients' best interests.

In 2020, I penned *In Defence of Financial Planners*, which spoke to some of the difficulties facing the financial advice industry, and the reasons why. I encourage you to read it. It offers a useful prologue to the latest inquiry, the title of which suggests the *quality* of financial advice is now under the spotlight.

What ever happened to just being able to give professional advice in your capacity as a professional, and trusting that there already exists a body of law which protects the consumer should that advice turn out to be wrong, negligent or inappropriate?

How have the lawyers, for example, been able to provide advice day-in day-out without the legislature (or their relevant Law Society) dictating what that advice should be or how it should look? No SOAs for lawyers. Funny how the legal profession hasn't crumbled as a result. The idea of regulating an 80-100 page advice document for lawyers comes across as quite ludicrous when you play out the narrative, doesn't it? Nonsensical perhaps. Certainly inefficient. And unnecessary. Obstructive. Inhibitive. And obviously very expensive. Probably means Australians would be less inclined to engage lawyers. That's problematic. And what if we went a step further and mandated a prescribed advice document every time the lawyer interacted with their client (clients aren't going to call their lawyer to discuss the weather - *pretty obvious they're seeking advice, right*)?

Now substitute "lawyer" for "financial adviser"…

"*But wait!*", exclaim the critics, "*you can't let financial advisers go unregulated*".

The same way legal advice is unregulated?

What, then, do we make of the fiduciary duty which the law says is owed by lawyers to their clients? Any basic consideration of the fiduciary duty under the general law speaks to notions such as:

- Acting in your client's best interests (*sound familiar?*);
- Avoiding conflicts of interest (*sound familiar?*);
- Prioritising your client's interest over yours (*sound familiar?*); and
- Clients placing their trust and confidence in you (*see a pattern emerging here?*).

Seems to have worked well enough over the centuries without needing to reduce it to a legislative checklist. It appears the legal profession trusts the judicial system to make those calls. Can you imagine

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if we left it to the legal profession's regulatory bodies to dictate whether or not a lawyer's advice to their client discharged the lawyer's fiduciary duty, or to dictate what that advice should have been? Imagine if the same regulatory body determined that the lawyer failed that duty, and as a consequence exercised its discretion to rip up the lawyer's practising certificate and obliterate their livelihood and everything they've worked for, and all the years spent obtaining their professional qualifications, skills and experience, at tremendous financial cost and sacrifice. All because a non-lawyer delegate of that regulatory body didn't like the content of the advice document, or the way it was presented, or because the lawyer earned a referral fee, or because the advice didn't neatly fit inside the delegate's checklist.

Now what if:

- That lawyer and their client had a 10+ year professional relationship;
- The client asked the lawyer for advice;
- The lawyer provided that advice;
- The parties agreed to the scope of, and the price for, that advice;
- The client consented to a referral fee being paid to the lawyer;
- The lawyer was satisfied that the advice was good for the client; and
- The client suffered no loss as a result of the advice, and indeed made substantial financial returns following implementation of that advice?

Look familiar?

Yet the sky hasn't fallen in for the legal profession. In fact, despite the absence of legislated advice prescription, clients enjoy healthy relationships of trust and confidence with their lawyers, the legal profession continues to thrive, more and more lawyers enter the profession (not exit in droves), and the profession enjoys a privileged and respected (some might even say honourable) place in the community. Even better: the negligent ones, the "dodgy" ones, shall we say, are dealt with appropriately.

But there's more: lawyers in private practice enjoy the benefit of limited liability under professional standards legislation. Yes, liability is capped. As the NSW Law Society neatly puts the proposition:

*[the schemes] are **specifically designed to promote professional standards, enhance consumer protection** and to enable private practice members to limit their civil liability to selected amounts.*

The NSW Bar Association says this (in relation to barristers):

*The New South Wales Bar Association Professional Standards Scheme **benefits the entire community**. Barristers are practising advocates and advisers, both in and out of the courtroom. **It is widely accepted that outcomes for clients improve significantly when there is competent legal advice and representation at the earliest possible stage of any dispute. In fact, the proper operation of our court system depends on the interaction between experienced judges and specialist advocates**.*

So, the "unregulated" provision of legal advice, among other things:

- Promotes professional standards;
- Benefits the community;
- Ensures consumers can access timely and affordable legal advice;

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- Ensures the provision of legal services;
- Enhances consumer protection; and
- Keeps insurance premiums down.

How does the heavily-regulated provision of *financial* advice stack up against each of these metrics?

Thankfully, Michelle Levy's *Quality of Advice Review* (**QAR**) potentially opens the door to a simplified and common-sense solution. I say *potentially* because the proposed reforms sit on the precipice of FOFA 2.0 if poorly handled by the Government. FOFA 1.0 speaks for itself: the industry doesn't need a reincarnation.

Among other things, the QAR:

- Calls out the failings of the "Best Interest Duty" under FOFA (**BID**);
- Recommends that the focus be on the content of advice rather than the adviser's conduct or processes in respect of that advice (the latter being what BID focuses on);
- Recommends scrapping BID with a duty to give "good advice"; and
- Recommends that advisers who meet professional standards should be subject to a new "statutory best interests duty" (with no "safe harbour").

Part of the QAR's rationale for the recommendations is to "*impose a true fiduciary duty on financial advisers who have undertaken to provide advice in the best interests of their clients*".

The following paragraph from the QAR is particularly apt, as it appears to set the scene for the recommendations around the provision of advice:

To be clear, a fiduciary duty to act in the best interests of a client is a stringent and important obligation. It requires the fiduciary to exercise their powers and discretions solely for the benefit of the beneficiary and so that they are honestly and freely able to do so it says the fiduciary cannot have a conflict and cannot accept a personal benefit other than with the consent of the beneficiary. In my view this expresses perfectly the duty that should apply to a financial adviser who is paid a fee for their advice…

…It borrows the language of a fiduciary duty, but the safe harbour steps and the duty of priority make it clear that it does not create or apply one.

Ms Levy (rightly in my view) comments that BID is *"neither a genuine fiduciary duty nor particularly effective at protecting consumers from poor advice*". On the fiduciary duty more broadly, Ms Levy says that:

- The Code of Ethics creates a "*true fiduciary duty*" to act in clients' best interests; and
- The recommended "statutory best interests duty" will be a "*true fiduciary duty that reflects the general law*".

Here's where, in my view, FOFA 2.0 risks conception. Or, worse still, a re-write of FOFA 1.0 which achieves a practical restatement of the status quo. Or, heaven forbid, the perpetuation of ridiculous concepts promulgated by the association once known for advocating the interests of its financial planning members, such as:

- "Robo" advice. *So we can subject clients' financial interests to the behest of the by-product of mechanical engagement: what was once financial advice instead a set of scripts capable of being delivered via artificial means*;

- "Digital" SOAs and "interactive advice". *Press 1 to continue to the "Authority to Proceed", or 2 if you do not wish to proceed. To view these options again, press 4…*; and

- "Video" SOAs. *Thanks for the call, client, but I'll need you to come in so I can record the advice you've asked me to give you. Please make sure you're suitably dressed. Hair styling and make-up will be available on-site…*

BID (that is, Division 2 of Part 7.7A of the Corporations Act) has to go. Simple as that. The QAR seems to agree.

The notion of "good advice" propounded in the QAR, whilst well-intentioned, is problematic in my view. This is because any attempt to create a statutory definition puts us back to where we left BID. Also, the current proposed definition adopts principles (such as "*fitness for purpose*") from Sale of Goods legislation and related case law, which does not have (and should not have) a place in the financial advice space. We're already regulated enough as it is, so let's leave sale of goods concepts to the ACCC and the State- and Territory-based Fair Trading jurisdictions. We're not selling fridges or TVs here – we just want to give advice which discharges our fiduciary obligations, without being dictated as to *how* we do that. We've seen how the regulator has handled BID when given a decade to ply a statutory definition of what personal advice should look like. And if there are vitiating factors (such as misleading and deceptive conduct) which compromise the advice relationship in the first place or the actual advice, there's an excellent regime which deals with these: the Australian Consumer Law.

Speaking of the "fiduciary duty" again, herein lies the crux of the issue at hand, and why FOFA 2.0 cannot be allowed to see the light of day: BID was derived from the "fiduciary duty" to begin with. The Explanatory Memorandum (**EM**) to the legislation which introduced FOFA makes this clear. The EM refers to "*fiduciary-like duties*", and separately an "*explicit fiduciary duty*", needing to be imposed on advisers.

BID purported to do that. The QAR acknowledges that BID "*borrows the language of a fiduciary duty*".

The problem? The relationship of financial adviser and client is already a fiduciary one. Advisers are already subject to a fiduciary duty under the general law. Yes, you guessed it, financial advisers, pre-FOFA (and without the assistance of FOFA since), are obliged to:

- act in their client's best interests;

- avoid conflicts of interest;

- prioritise their client's interest over their own; and

- obtain their client's consent if they are to financially gain from the relationship.

The QAR effectively concedes this proposition. I quote:

Financial advisers have skills and expertise and consumers look to them for independent advice. If they seek investment advice from a financial adviser and they pay a fee for that advice, they expect that they will get the 'best outcome' – being the best investment products or best life insurance products for their objectives, financial situation and needs. (This is not the same as expecting the best performance measured in hindsight). And so, to paraphrase Commissioner Hayne, the client of a financial adviser expects and is entitled to expect that their adviser will act in their interests when they provide their advice. ***This is consistent with the general law which imposes fiduciary obligations on a person who undertakes to act in the interests of another person in circumstances where that other person could be exposed to harm or detriment if the fiduciary acts for another purpose****.*

Begs the obvious question in reply: why, then, the need for statutory prescription? BID proved (unequivocally in my view) that statutory prescription or codification of general law obligations (especially when those obligations are founded in *equity*) don't work. They especially don't work when

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the statutory powers afforded by the prescription are statutorily given to the wrong person, and not left for the Courts to properly determine (ie in accordance with the general law).

What BID accomplished instead, was a completely different set of rules, operating under the guise of "fiduciary duties". And the regulator, consequently, wrote its own rules which had nothing to do with the general law. Instead, they adopted their own checklist of what does and does not infringe BID, and wielded the axe accordingly. The outcome? BID is failed – and the banning order regime is consequently enlivened - when that same alleged conduct would not infringe the adviser's fiduciary duty when determined as it should be determined – by the Courts and pursuant to the general law. That disconnect cannot be allowed to resurface in any revised shape or form.

Which leads conveniently to my next point: the proposed "statutory best interests duty" will (at least in a practical sense) be BID all over again. In its current form. And subject to its current interpretation and approach by the regulator. Meaning advisers' livelihoods remain at risk of obliteration because of conduct which falls well short of that which would infringe the general law (and proper) version of the "*true fiduciary duty*". Worse still, it energises precisely what the QAR is seeking to avoid and one of the premises on which the QAR was commissioned in the first place: process-based advice which has become more expensive for consumers.

The proposed statutory prescription (or, specifically, the rationale for it) risks taking us back to where we started on this journey 12 years or so ago. I'd prefer to take my chances on the lawyers and the judicial system. So let's revert back to them to determine these questions.

Having said that, the QAR – if properly handled – represents a welcome inflexion point for the industry, and the opportunity should be seized to both advocate and legislate the themes which clearly emanate (directly and indirectly) from Ms Levy's report, including:

- Dismantling statutory advice document prescription and annual disclosures (frankly, just get rid of SOAs and FDSs – Ms Levy's proposals in this regard should be endorsed);

- Creating a true advice "profession", which by definition should encompass limited liability under professional standards legislation in a similar way enjoyed by other professions such as legal and accounting;

- A refocus on the general law as the sensible and appropriate benchmark for regulating the discharge of financial advisers' fiduciary duties to their clients; and

- A single registration body and association through which financial advisers are registered to provide financial services, supported in professional practice, and disciplined for poor conduct. We could do worse than look to the Law Societies as precedent.

Who knows – the Australian economy might just benefit from a thriving financial advice profession as well.

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