REGULATING FINANCIAL ADVISERS IN THE UK: LESSONS FOR AUSTRALIA

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Prompted by the 2008 Global Financial Crisis, the Australian government introduced the Future of Financial Advice reforms in 2013. It aimed to improve the quality of financial advice by virtue of a best interests duty and a ban on conflicted remuneration, inter alia. Despite the reforms, public trust in financial advisers remains unacceptably low. Adviser misconduct, driven by conflicted self-interest, remains prevalent. By contrast, there is relatively greater trust in financial advisers in the United Kingdom ('UK'). This article focuses on how the UK regulates financial advisers, where the best interests duty and suitability rule also apply. The analysis that follows is confined to the legislative text. The UK regulatory regime offers directions and possibilities for further Australian reforms.

I INTRODUCTION

Compulsory superannuation renders financial advice vital in Australia.[1] Australia's financial services sector is the largest contributor to the national economy – $140 billion to GDP. Demand for financial advice is high: 2.6 million Australians would turn to financial advisers for advice, up from 2.1 million in 2019.[2] Such strong market demand raises a question as to how financial advisers are regulated in Australia. The Australian regulatory framework concerning financial advice has evolved over time. The most recent reforms, the Future of Financial Advice ('FOFA') reforms, passed a package of FOFA legislation through Parliament in 2012.[3] The FOFA package replaced the 'suitability rule' under the old section 945A of the *Corporations Act 2001* (Cth) ('*CA*') with a view

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1 Richard Batten and Gail Pearson, 'Financial Advice in Australia: Principles to Proscription; Managing to Banning' (2013) 87(2–3) *St John's Law Review* 511, 512.

2 Kim Loong Choi, Investment Trends, 'Demand for Financial Advice Doubled in the Last Five Years: Investment Trends 2020 Financial Advice Report', *AdviserVoice* (Web Page, 9 September 2020) <https://www.adviservoice.com.au/2020/09/demand-for-financial-advice-doubled-in-the-last-five-years-investment-trends-2020-financial-advice-report/>.

3 *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth); *Corporations Amendment (Future of Financial Advice) Act 2012* (Cth).

to enhancing consumer protections in light of the Global Financial Crisis ('GFC') and certain domestic financial scandals.[4]

The FOFA reforms shifted the focus of financial advice regulation from the 'suitability rule' to the 'best interests duty' and 'related obligations', eg, the appropriate advice duty.[5] Moreover, the FOFA package introduced a ban on conflicted remuneration in the form of 'fee for advice' and implemented measures intended to promote greater transparency. The 'fee for advice' ban has changed the way advisers are remunerated and was intended to align the interests of the clients with those of the financial advisers.[6] On top of these, Australian financial services licence ('AFSL') holders were all required, as a general rule, to provide services efficiently, honestly, and fairly.[7] Despite these reforms, an April 2016 poll revealed that the level of public trust in financial advisers remained unsatisfactory, with almost two-thirds of Australian voters favouring the establishment of a *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* ('*Royal Commission*').[8] In his 2019 Final Report for the *Royal Commission* ('*Final Report*'), Commissioner Hayne called on the government to address a number of issues in the financial advice industry. Commissioner Hayne underscored the role of the best interests duty, noting that:

> Although the fundamental obligation is cast as a 'best interests duty' there is no explicit reference in the legislation to making comparisons of a kind that would merit the use of the superlative 'best' in the collocation 'best interests'. Instead, the Corporations Act provides that the best interests obligation will be met if an adviser follows the steps described in section 961B(2). Section 961B(2) is a 'safe harbour' provision. Six steps must be taken, and there is a seventh and general catch-all provision requiring the adviser to take any other step that 'would reasonably be regarded as being in the best interests of the client'.[9]

In his view, however, the safe harbour provision can hardly serve the purpose of the best interests duty. The steps set forth in the safe harbour provision are a handy, albeit flawed, tool. For example, Commissioner Hayne, reflecting on the step of 'conduct[ing] a reasonable investigation' into which financial products might fulfil the client's objectives and needs, opined that it 'requires the adviser to make little or no independent inquiry into, or assessment of, products. Instead, in most cases, advisers and licensees act on the basis that the obligation to conduct a reasonable investigation is met by choosing a product from the licensee's "approved products list"'.[10] As stated by Commissioner Hayne, the safe harbour provision is 'little more than a box-ticking' exercise, and he thus suggested that

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4 Han-Wei Liu et al, 'In Whose Best Interests? Regulating Financial Advisers, the Royal Commission and the Dilemma of Reform' (2020) 42(1) *Sydney Law Review* 37, 40–2.

5 *Corporations Act 2001* (Cth) s 961G, as inserted by the *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth) s 23.

6 *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth) s 24.

7 *Corporations Act 2001* (Cth) s 912A(1)(a).

8 Katharine Murphy, 'Most Australians Want Banking Royal Commission: Guardian Essential Poll', *The Guardian* (online, 28 November 2017) <https://www.theguardian.com/australia-news/2017/nov/27/most-australians-want-banking-royal-commission-guardian-essential-poll>.

9 *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, February 2019) vol 1, 167 ('*Final Report*') (emphasis altered).

10 Ibid 167–8.

the government consider its repeal '[u]nless there is a clear justification for retaining it'.[11] In Part 3.3 of the first volume of the *Final Report*, Commissioner Hayne traced the root of these problems by linking misconduct and poor advice with pervasive conflicts of interest in the industry. Among others, two issues were identified to be of particular concern.[12] For one, despite the ban on conflicted remuneration, the grandfathering provision nevertheless allowed exemptions.[13] For another, vertical integration in the Australian financial industry has led financial advisers – in particular those within the firms controlled by the five largest banking and financial institutions – to recommend their in-house products, even though third party products made up around 80% of their approved product lists.[14] These problems resulted in Commissioner Hayne's recommendations that the government should reconsider its strategies for dealing with conflicts. His Honour urged that '[g]randfathering provisions for conflicted remuneration should be repealed as soon as is reasonably practicable', and that the law should be amended to require better disclosure, 'explaining simply and concisely why the adviser is not independent, impartial and unbiased'.[15]

In contrast to Australia, the United Kingdom ('UK') reports relatively high levels of satisfaction in the financial advice industry, in both 2017 and 2018, with 79% of people either very satisfied or satisfied with the services received from their adviser.[16] The level of trust in the advice by individuals in the UK is noteworthy. The rapport between advisers and clients is mostly longstanding and well-established: 57% of respondents reported high levels of trust in their adviser or affiliated firm, 50% were highly satisfied with the advice received, and only 18% of people reported low levels of trust.[17] Further, of those who did not receive financial advice, only 15% expressed a reluctance to receive advice due to cost.[18] A lack of trust in financial advisers was only a concern for a small subset of those interviewed.[19] These relatively higher levels of trust raise a series of intriguing questions: how does the UK, as a matter of law, regulate financial advisers? What are the key instruments used to address the conflicts of interest and maintain market integrity? How are they different from (if any) those tools employed by the FOFA reforms in Australia? What lessons might be drawn to better the Australian regulatory framework?

11 Ibid 26, 496.
12 Ibid 164–5.
13 Ibid 182, citing *Corporations Act 2001 (Cth)* pt 7.7A div 4 sub-div 5.
14 Ibid 168, citing Australian Securities & Investments Commission, *Financial Advice: Vertically Integrated Institutions and Conflicts of Interest* (Report No 562, January 2018) 28 ('*ASIC Report 562*'); institutions surveyed were AMP Financial Planning Pty Limited, ANZ Financial Planning, Commonwealth Financial Planning Limited, NAB Financial Planning and Westpac Financial Planning: at 24 [93].
15 *Final Report* (n 9) 176.
16 Edward Ripley et al, Financial Conduct Authority, *The Changing Shape of the Consumer Market for Advice: Interim Consumer Research to Inform the Financial Advice Market Review (FAMR)* (Report, August 2018) 13.
17 Ibid 27.
18 Ibid 42.
19 Ibid 27, 42.

In this article, we explore these issues by focusing on the dimension of 'law in books', while addressing the concerns around 'law in action' elsewhere.[20] More specifically, we consider the regulatory framework in the UK, and examine the issues in relation to the 'best interests duty' and 'suitability rule' in Part II. Other mechanisms that help manage conflicts of interest – notably, the ban on conflicted remuneration and disclosure on independent/non-independent advice – will be also considered in this Part. As the UK has long been part of the European Union ('EU') until January 2020, the British model is heavily influenced by two EU Directives – namely, *Markets in Financial Instruments Directives I* and *II* ('*MiFID I*'[21] and '*MiFID II*'[22]).[23] Therefore, it is helpful to consider the UK model within the broader context of EU law. The analysis will then inform our reflection upon the current framework of financial advisers' regulation in Australia (Part III). Part IV discusses the lessons for Australia and maps out directions for future reforms in the post Royal Commission era. Part V concludes.

II THE UK MODEL FOR REGULATING FINANCIAL ADVISERS

A The Influence of the EU and the Effects of the GFC

The first Markets in Financial Instruments Directive ('*MiFID I*') was adopted by the EU in 2004 as a push to standardise the regulation of particular sectors in the EU.[24] *MiFID I* regulated businesses which provided services to clients in relation to 'financial instruments' and the venues where they were sold.[25] Article 19(4) of *MiFID I* required that where investment advice is provided, the firm must obtain necessary information about the client and their situation in order to recommend 'investment services and financial instruments that are suitable for

20 Some of them have been addressed in Liu et al (n 4).

21 *Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on Markets in Financial Instruments Amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC* [2004] OJ L 145/1.

22 *Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and Amending Directive 2002/92/EC and Directive 2011/61/EU* [2014] OJ L 173/349.

23 To maintain its market access rights to the EU, the UK has to make equivalent arrangements in various areas, including financial services. To this end, the UK firms would be required to comply with *MiFID II* and additional requirements as required by the EU. This has been made clear in the European Securities and Markets Authority, *Draft Technical Standards on the Provision of Investment Services and Activities in the Union by Third-Country Firms under MiFID II and MiFIR* (Consultation Paper, 31 January 2020), published on the day on which Brexit officially became effective. It remains to be seen, therefore, how both parties would negotiate such equivalent arrangements that can affect the UK's framework on financial advisers.

24 Niamh Moloney, 'Large-Scale Reform of Investor Protection Regulation: The European Union Experience' [2007] (4) *Macquarie Journal of Business Law* 147, 148.

25 'Financial Instruments' is defined in annex I, section C of *MiFID I*, and includes an expansive list of instruments focusing on transferable securities, money-market instruments, units in collective investment undertakings and options, futures, swaps, forward rate agreements and other derivative contracts relating to securities.

him'.[26] This may be said to have represented the EU's intent to reshape the firm/investor relationship and formulate strict regulations for suitability assessments.[27] It was designed to 'establish a rigorous investor protection regime … to encourage the development of a stronger retail market'.[28] In July 2007, the Financial Services Authority ('FSA') – later rebranded as the Financial Conduct Authority ('FCA') – issued rules for the implementation of the suitability and appropriateness tests contained in *MiFID I*.[29] Additionally, the *Conduct of Business Sourcebook* ('*COBS*')[30] was implemented as the successor to the Conduct of Business rules ('COB').[31]

The UK was affected by the Global Financial Crisis ('GFC'), with consequences including a 'near meltdown in the banking system', '[t]he credit crunch', and 'the bursting of the UK's decade-old house price bubble'.[32] The crisis energised a refocus on national economic policy, shifting from 'light-touch financial regulation' to 'a surge in government borrowing and the introduction of new instruments of financial regulation'.[33] The rationale for financial regulation – which had long centred on 'market efficiency' – was challenged under a need to prioritise a 'broader form of economic public interest' in the wake of the financial crisis, 'such as in collective financial stability'.[34] Moreover, the concerns of the financial crisis were centred on the issue of product suitability, as local authorities and municipalities suffered 'significant losses because they were sold financial instruments which were inappropriate for their needs', for instance, in relation to 'interest-rate swaps'.[35] While the conditions that catalysed the crisis – such as information asymmetry – were endemic even prior to the crisis, the failings of 2007–08 illuminated these adverse impacts.[36]

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26 *MiFID I* (n 21) art 19(4).
27 Ibid.
28 Moloney (n 24) 157.
29 Financial Services Authority, *Responsibilities of Providers and Distributors for the Fair Treatment of Customers: Feedback on DP06/4* (Policy Statement No 07/11, July 2007).
30 Conduct of Business Sourcebook, Financial Conduct Authority (at October 2020) <https://www.handbook.fca.org.uk/handbook/COBS.pdf> ('*COBS*').
31 Contained within the FCA's Handbook, *COBS* establishes rules applicable to designated investment firms: page 1 [1.1.1]. *COBS* replaced the *COB* in November 2007: Simon Collins, 'The Regulatory Framework', *Chartered Insurance Institute* (Web Page, 8 November 2018) <https://web.archive.org/web/20181112050856/http://cii.co.uk/knowledge/mortgages/articles/the-regulatory-framework/7041>.The Handbook contains binding obligations backed by enforcement action from the FCA, as well as interpretive assistance related to the Financial Services and Markets Acts ('FSMA'); hence, the court must interpret the FSMA through the lens of the *COBS* provisions: see Burges Salmon, 'Interaction Between Regulatory Enforcement and Civil Proceedings' (Briefing, Financial Service Series No 9, June 2014) <https://www.burges-salmon.com/-/media/files/publications/open-access/financial_services_series_issue_9.pdf>.
32 Dermot Hodson and Deborah Mabbett, 'UK Economic Policy and the Global Financial Crisis: Paradigm Lost?' (2009) 47(5) *Journal of Common Market Studies* 1041, 1041.
33 Ibid 1042.
34 Iris HY Chiu, 'A Rational Regulatory Strategy for Governing Financial Innovation' (2017) 8(4) *European Journal of Risk Regulation* 743, 743.
35 Financial Conduct Authority, *Markets in Financial Instruments Directive II Implementation: Consultation Paper III* (Consultation Paper No CP16/29, September 2016) 150.
36 Ibid 150–1.

In many ways, the GFC acted to accelerate regulatory change. Unclear risks and unfair treatment of retail customers had been longstanding issues within the UK financial system – the financial crisis accentuated these harms and reflected the problems 'created by asymmetry of power and information between providers, advisers and consumers, together with unsustainable business models'.[37] The financial crisis 'highlighted limits in the ability of non-retail clients to fully appreciate investment risks'.[38] Driven in part by these concerns, the *MiFID I* was modified and updated in the new Markets in Financial Instruments Directive (*MiFID II*) regime, changing the client categorisation system to more suitably recognise the different levels of experience, knowledge and expertise of various clients.[39] In the UK, Chapter 9A of *COBS*, issued by the FCA under the mandate of the *Financial Services and Markets Act 2000* (UK), incorporated the changes embedded within *MiFID II*, including additional demands such as periodic suitability assessments and periodic suitability reports.[40] Effectively, this seems to function as a response to the demands and concerns of the financial crisis – fears that risk was inadequately assessed by advisers before and during the crisis necessitated more stringent risk assessments in the reformed suitability regime.

To regulators, the root causes of the GFC were intertwined with deeply embedded problems in the retail investment market – the crisis exposed these previously latent fallibilities.[41] Long-term implications of these flaws necessitated the 'requirement to rebuild trust: trust in the [political] system and trust in those who operate it'.[42] Indirectly, the crisis rendered the objectives of reforms extremely urgent, and, in particular, exposed flaws in risk assessment which led to more stringent suitability assessment and reporting procedures. Although the GFC did not radically reshape the suitability rule, it did provide a substantial catalyst for many policy and regulatory actions in the UK over the last decade. Against this historical backdrop, we will now proceed to explore the UK regime in greater detail.

B Best Interest Rule in the UK

Obligations in *COBS* are predominantly sourced from *MiFID I* and its *Implementing Directive*.[43] *COBS* 2.1.1R copied Article 19(1) of the Level 1

37 Treasury Committee, *Retail Distribution Review* (House of Commons Paper No 15, Session 2010–12) vol 1 ev 24 [11].

38 Financial Conduct Authority, *Markets in Financial Instruments Directive II Implementation: Consultation Paper III* (Consultation Paper No CP16/29, September 2016) 36.

39 *MiFID II* (n 22) annex II.

40 Taylor Wessing, *MiFID II User Guides* (Guide, 10 February 2017) 13.

41 Treasury Committee, *Retail Distribution Review* (House of Commons Paper No 15, Session 2010–12) vol 1 ev 24 [11].

42 Andrew Massey, 'Nonsense on Stilts: United Kingdom Perspectives on the Global Financial Crisis and Governance' (2011) 11(1) *Public Organization Review* 61, 73.

43 Victoria Stace, 'New Zealand's Financial Adviser Regulations: Falling Behind in the Wake of Overseas Reform' (2016) 26(4) *New Zealand Universities Law Review* 1, 14, citing *MiFID I* (n 21) and *Commission Directive 2006/73/EC of 10 August 2006 Implementing Directive 2004/39/EC of the European Parliament and of the Council as Regards Organisational Requirements and Operating Conditions for Investment Firms and Defined Terms for the Purposes of that Directive* [2006] OL J 241/26.

Directive of *MiFID I* – a directive which was issued[44] through the so-called 'Lamfalussy process',[45] engaging the same wording of requiring a firm to act '*honestly*, *fairly* and *professionally* in accordance with the *best interests of its clients*'.[46] Notably, the then FSA had made clear that it was necessary to copy out Article 19(1) in full due to the distinction between the best interests duty and the then existing Principle 6 requiring firms to 'pay due regard to the interests of its customers and treat them fairly'.[47] This raises questions of whether the best interests duty imposes an additional fiduciary-style obligation.[48] *COBS* 2.1.1R has been described by some as a fiduciary-like duty.[49] Principally, *COBS* 2.1.1R reflects its origins in the *MiFID* regime. The best interests duty conceptually extends as an overarching obligation in the *MiFID* framework.[50] Therefore, the best interests duty in the UK context should operate similarly to the best interests duty under the *MiFID* regime – which fulfils the role of a mechanism to supplement other rules, including the suitability rule or in other words, acts as a gap-filler.[51]

1 The Notion of Independent Advice under the EU and the UK Regimes

One noticeable improvement made by *MiFID II* was the introduction of a distinction between 'independent' and 'non-independent' advice.[52] Article

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44 Financial Services Authority, *Implementing the Markets in Financial Instruments Directive* (MiFID) (Policy Statement No 07/2, January 2007) 79 [1.2] (emphasis added).

45 'Lamfalussy process' refers to a four-level regulatory approach: Alexandre Lamfalussy et al, *Final Report of the Committee of Wise Men on the Regulation of European Securities Markets* (Report, 15 February 2001) 19 ff. At level one, the European Parliament and Council adopt basic laws proposed by the Commission. At level two the Commission can choose to adopt, adapt or update the measures with help from consultative bodies. At level three, the committees of national supervisors are to advise the Commission as to the adoption of level one and two. Finally, at level four the report advocates for a stronger role for the Commission in ensuring the EU rules are enforced by national governments.

46 Financial Services Authority, *Implementing the Markets in Financial Instruments Directive (MiFID)* (Policy Statement No 07/2, January 2007) 79 [1.2] (emphasis added).

47 Ibid 79 [1.3]–[1.4].

48 Simone Degeling and Jessica Hudson, 'Financial Reobots as Instruments of Fiduciary Loyalty' (2018) 40(1) *Sydney Law Review* 63.

49 Folarin Akinbami, 'The Fiduciary Duties of Institutional Investors' in Roman Tomasic (ed), *Routledge Handbook of Corporate Law* (Taylor & Francis, 2016) 106. Commentators have argued the 'best interests duty' connects to a fiduciary relationship as a reworded specification 'under the general umbrella of the "fiduciary duty"': see, eg, Jean-Pierre Casey and Karel Lannoo, *The MiFID Revolution* (Cambridge University Press, 2009) 46. Furthermore, Moloney characterised the best interests duty as a 'foundation[ally] fiduciary-style obligation': Niamh Moloney, *How to Protect Investors: Lessons from the EC and the UK* (Cambridge University Press, 2010) 215. Tension has then emerged in reconciling a 'best interests duty' with fiduciary duty where the advice is given at an arms-length interaction: Luca Enriques and Matteo Gargantini, 'The Overarching Duty to Act in the Best Interest of the Client in MiFID II' in Danny Busch and Guido Ferrarini (eds), *Regulation of the EU Financial Markets: MiFID II and MiFIR* (Oxford University Press, 2017) [4.70] ('*Regulation of the EU Financial Markets*'). This issue was also debated in Australia: see below n 150 and our discussions in Part III(B).

50 Luca Enriques and Matteo Gargantini, 'The Expanding Boundaries of MiFID's Duty to Act in the Client's Best Interest: The Italian Case' (2017) 3(2) *Italian Law Journal* 485, 491.

51 Ibid 494.

52 *MiFID II* (n 22); *COBS* (n 30) 6.2B.10G–6.2B.11R, 6.2B.33R; Danny Busch and Guido Ferrarini, 'Who's Afraid of *MiFID II*: An Introduction' in Danny Busch and Guido Ferrarini (eds), *Regulation of the EU Financial Markets* (n 41) [1.20].

24(4)(a) of *MiFID II* attaches the requirement 'to the service and not to the firm',[53] evidencing that a label of 'independent' or 'non-independent' is not tied to an 'adviser', but instead to 'advice'. Firms are also subject to information obligations and must inform clients of whether or not advice is independent.[54] According to Article 24(7) of *MiFID II*, independent advice necessitates an assessment of 'a *sufficient range of financial instruments available* on the market which must be *sufficiently diverse* with regard to their type and issuers or product providers to ensure that the client's investment objectives can be suitably met'.[55] To be independent, financial instruments must therefore be of a sufficiently diverse type and origin,[56] and be provided under an established selection process, including considerations such as the proportionality and representativeness of financial products.[57]

Failing to meet these conditions, the advice will be instead deemed 'non-independent'.[58] Advisers providing non-independent advice can assess a limited range of financial instruments and be paid by third parties.[59] Where robust comparison of financial products is not possible, a firm may not present its advice as independent.[60]

Such a distinction may be driven by the behaviour of firms before the *MiFID II*. Firms actively promoted themselves as independent advisers – and this representation 'could only be challenged on the grounds of misleading marketing'.[61] It was necessary that a distinction be drawn to promote transparency; through *MiFID II*, advisers can no longer 'pretend to be "independent"'.[62] Simultaneously, the EU policymakers decided that an absolute ban on dependent advice would make financial advice unaffordable for vulnerable investors.[63] This suggests a preference for some conflicted advice as opposed to no advice[64] – however, critics have noted that there is a risk that clients will not recognise

53 *MiFID II* (n 22) art 24(4)(a) , cited in Paolo Giudici, 'Independent Financial Advice' in Danny Busch and Guido Ferrarini (eds), *Regulation of the EU Financial Markets* (n 49) [6.31]. See also *COBS* (n 30) 6.2B.11R.

54 *MiFID II* (n 22) art 24(4)(a)(i); *COBS* (n 30) 6.2B.33R; Danny Busch, 'MiFID II: Stricter Conduct of Business Rules for Investment Firms' (2017) 12(3) *Capital Markets Law Journal* 340, 354.

55 *MiFID II* (n 22) art 24(7)(a), quoted in Paolo Giudici, 'Independent Financial Advice' in Danny Busch and Guido Ferrarini (eds), *Regulation of the EU Financial Markets* (n 49) [6.21] (emphasis added).

56 *MiFID II* (n 22) art 24(7); *COBS* (n 30) 6.2B.11R; Paolo Giudici, 'Independent Financial Advice' in Danny Busch and Guido Ferrarini (eds), *Regulation of the EU Financial Markets* (n 49) [6.21].

57 *MiFID II* (n 22) art 24(7), discussed in Busch, 'MiFID II: Stricter Conduct of Business Rules for Investment Firms' (n 54) 353.

58 Cf *COBS* (n 30) 6.2B.11R.

59 Paolo Giudici, 'Independent Financial Advice' in Danny Busch and Guido Ferrarini (eds), *Regulation of the EU Financial Markets* (n 49) [6.24]; cf *MiFID* (n 21) art 24(7)(c).

60 *MiFID II* (n 22) art 24(7); Busch, 'MiFID II: Stricter Conduct of Business Rules for Investment Firms' (n 54) 353.

61 Paolo Giudici, 'Independent Financial Advice' in Danny Busch and Guido Ferrarini (eds), *Regulation of the EU Financial Markets* (n 49) [6.23].

62 *MiFID II* (n 22) art 24; Paolo Giudici, 'Independent Financial Advice' in Danny Busch and Guido Ferrarini (eds), *Regulation of the EU Financial Markets* (n 49) [6.24].

63 Paolo Giudici, 'Independent Financial Advice' in Danny Busch and Guido Ferrarini (eds), *Regulation of the EU Financial Markets* (n 49) [6.24].

64 Ibid.

possible bias as they may not read information notifying them of non-independence.[65]

In contrast, the UK Retail Distribution Review in 2006 ('2006 RDR') banned commissions and other third-party benefits altogether.[66] Previously, the UK allowed certain commission payments and other benefits provided that a firm complied with its disclosure obligations.[67] Yet, in June 2009, the FSA settled on a distinction between 'independent advice' and 'restricted advice'.[68] The then FSA later clarified that advisers providing independent advice 'should not be restricted by product provider[s]', and should 'be able to objectively consider all types of retail investment products … which are capable of meeting the investment needs and objectives of a retail client'.[69] The standard for independent advice is a personal recommendation that is a) 'based on a comprehensive and fair analysis of the relevant market', and b) 'unbiased and unrestricted'.[70] 'Restricted advice', by contrast, is a) 'a personal recommendation to a retail client in relation to a retail investment product which is not independent advice', or b) 'basic advice'.[71] Similar to the *MiFID II* regime, advice which does not meet the standard for independent advice will fall under the other category – in this case, 'restricted advice'.[72] While restricted advice is subject to the same suitability and adviser charging standards applied to independent advice, it mandates disclosure of the nature of the restriction under *COBS* 6.2A.6R.[73] Though commissions are banned in the UK, as elaborated upon further below, advice of this nature may include other restrictions such as advice constrained to a limited range of product providers.[74] It is likely that this restriction was implemented for the similar purpose of pursuing transparency in the self-promotion of financial advisory services.

2 2013 Ban on Conflicted Remuneration

The 2006 RDR was initiated to identify and reform endemic problems within the UK investment market.[75] One investigatory area centred on commission-based models of payment, which arguably misaligned the interests and information

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65 Busch, 'MiFID II: Stricter Conduct of Business Rules for Investment Firms' (n 54) 355.

66 Financial Services Authority, *Distribution of Retail Investments: Delivering the RDR* (Consultation Paper No 09/18, June 2009) 26 [4.13] ('*Consultation Paper June 2009*'); Paolo Giudici, 'Independent Financial Advice' in Danny Busch and Guido Ferrarini (eds), *Regulation of the EU Financial Markets* (n 49) [6.24].

67 Gerard McMeel, 'International Issues in the Regulation of Financial Advice: A United Kingdom Perspective' (2013) 87(2–3) *St John's Law Review* 595, 608–9.

68 Ibid 612; *Consultation Paper June 2009* (n 66) 15 [2.26].

69 Financial Services Authority, *Retail Distribution Review: Independent and Restricted Advice* (Guidance Consultation, February 2012) 2 [1.2]. See also *COBS* (n 30) 6.2B.15EU.

70 Financial Services Authority, *Retail Distribution Review: Independent and Restricted Advice* (Guidance Consultation, February 2012) 3 [2.2].

71 Ibid 7–8 [3.1].

72 Ibid 8 [3.2]; *COBS* (n 30) 6.2B.30G.

73 Financial Services Authority, *Retail Distribution Review: Independent and Restricted Advice* (Guidance Consultation, February 2012) 8 [3.3].

74 Ibid 8 [3.5]; see below Part II(B)(2).

75 Financial Services Authority, *A Review of Retail Distribution* (Discussion Paper No 07/1, June 2007) 3 [3]–[4].

provided by advisory firms.[76] The review culminated in the recommendation that commission-based payments be eliminated in favour of an 'adviser charging' model.[77] Before the 2006 RDR's adviser charging reforms were implemented in late 2012, firms earned different amounts of money from providers depending on which provider they recommended.[78] The 2006 RDR criticised the damaging conflicts of interests within commission payments, favouring a system where firms set their own charges.[79] The proposal suggested that all firms should be paid through '[a]dviser [c]harging', a system comprising of 'charges that they have set out upfront and agreed with their clients'.[80] Charges should, in turn, 'reflect the services being provided to the client, not the particular product provider, or product, being recommended'.[81] A March 2010 *Policy Statement* formed the final iteration of the consultative process, finalising the rules on remuneration to be incorporated at the end of 2012.[82] In 2013, the ban on commissions was implemented as 6.1A.4R(2) in *COBS*. Since its implementation in 2013, the policy has undergone extensive critique and reform.[83]

Equally, reforms deliver several advantages to firms and product providers. As substantial detriments for consumers analogously threaten the long-term viability of firms,[84] sustainable business practice depends on the fair treatment of customers and the appropriateness of a product.[85] Moving from 'a model that relies heavily on upfront revenue' to 'recurring revenue models' incentivised firms to adopt such long-term business strategies.[86] Although this ban played a key role in maintaining market integrity, it was one factor among other factors that shaped the level of public trust in the UK's financial advisers.[87] Thus, it may be problematic to 'attribute any changes in levels of trust to the [2006] RDR [or the commission ban] specifically'.[88]

Nevertheless, the majority of respondents to the *Financial Advice Market Review*'s Call for Input felt that 'the RDR had been successful in increasing professionalism in the advice industry'.[89] Trust in financial advisers among existing clients remained high, likely derived from the ongoing adviser-client

76 Ibid 48–9 [3.51]–[3.54].
77 *Consultation Paper June 2009* (n 66) 23–4 [4.4]–[46].
78 Ibid 23 [4.1].
79 Ibid.
80 Financial Services Authority, *Distribution of Retail Investments: Delivering the RDR* (Policy Statement No 10/6, March 2010) 25 [4.4] ('*Policy Statement*').
81 Ibid.
82 *Policy Statement* (n 80).
83 In August 2015, the Financial Advice Market Review (FAMR) was launched, which continued the work of the RDR 2006; Financial Conduct Authority, 'Financial Advice Market Review' (Final Report, March 2016) 3.
84 Financial Services Authority, *A Review of Retail Distribution* (Discussion Paper, June 2007) 48 <https://www.fca.org.uk/publication/discussion/fsa-dp07-01.pdf> (*Discussion Paper*).
85 Ibid.
86 Ibid 52.
87 Europe Economics, *Retail Distribution Review: Post Implementation Review* (Report, 16 December 2014) 25.
88 Ibid.
89 Her Majesty's Treasury and Financial Conduct Authority, *Financial Advice Market Review* (Final Report, March 2016) 17 ('*Financial Advice Market Review*').

relationship.[90] Some evidence indirectly implied increased engagement, as disproportionately more clients began paying for advice compared to a smaller number who stopped.[91] However, respondents also consistently noted that there were 'significant minimum costs per customer associated with supplying face-to-face advice', affecting the availability of services for 'consumers with lower amounts to invest'.[92]

After the ban, the majority of respondents to the Financial Advice Market Review's Call for Input felt that 'the RDR had been successful in increasing professionalism in the advice industry'.[93] Increased transparency re-aligned the focus of advisers to the individualised needs of customers in an environment where the threshold of the customer's buy-in had been raised by higher minimum standards.[94] When the customer had to be incentivised to pay a fee and did not assume that the service was free, a higher and more suitable quality of service was necessary.[95] Nonetheless, some fears materialised as affordability did become a greater concern for access.[96]

To derive a benefit from the commission ban, the gains of increased trust and quality of advice must outweigh the harms of those who are disincentivised from seeking advice in the first place. In the first instance, it is inconclusive whether the reforms contributed to an increase or decrease in engagement – with the evidence only indirectly suggesting that access had improved.[97] Nonetheless, it seems that encouraging customers to reconsider their views on the industry may leverage increased integrity and trust to encourage advice-seeking.[98] To the extent that consumer demand is largely influenced by trust, the remaining difficulty is the high cost of advice. This issue continues to be addressed by the FCA, which has conducted research into robo-advice and lowering advice costs.[99]

Notwithstanding the adverse ramifications of the ban, it does seem that tangible benefits have eventuated. The majority of those aware of the reforms reported that the industry had improved, their perception of advisers becoming more professional.[100] Similarly, advice professionals noted that advisers were required to provide more suitable advice as their incentives were influenced by the ban.[101] Professionals themselves have changed their minds about the efficacy of

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90 Europe Economics (n 87) 25.
91 Ibid 28.
92 *Financial Advice Market Review* (n 89) 19.
93 Financial Conduct Authority, *Financial Advice Market Review* (Final Report, March 2016) 17.
94 Bob Veres, 'How the UK RDR Ban on Commissions Increased Demand for Financial Advice', *Kitces* (Blog Post, 19 December 2016) <https://www.kitces.com/blog/uk-rdr-commission-ban-increases-financial-advice-demand/>.
95 See generally ibid.
96 *Financial Advice Market Review* (n 89) 6.
97 Europe Economics (n 87) 28.
98 Ibid 27.
99 Siobhan Riding, 'Watchdog Probes Financial "Advice" Gap', *Financial Times* (online, 1 May 2019) <https://www.ft.com/content/f675a6e2-6bf4-11e9-80c7-60ee53e6681d>.
100 *Financial Advice Market Review* (n 89) 17.
101 Bob Veres, 'How the UK RDR Ban on Commissions Increased Demand for Financial Advice', *Kitces* (Blog Post, 19 December 2016) <https://www.kitces.com/blog/uk-rdr-commission-ban-increases-financial-advice-demand/>.

the ban, constituting a significant influence for those who do engage with the industry.[102] The main remaining issue of perception are those who are unaware of the changes, and hence remain unwilling to engage with the industry due to mis-selling in the past.[103]

There is one legacy issue of trail commissions. Trail commissions refer to 'ongoing payments from within a super/investment or insurance account … usually paid to a financial adviser'.[104] These were incurred by some investment products purchased before 31 December 2012.[105] Following the 2006 RDR reforms, commissions – including trail commissions – were banned on new investment products purchased after 31 December 2012.[106] Yet, 'a financial adviser … can continue to receive trail commission for advice on investments … bought before 31 December 2012'.[107] While the FCA considered the possibility of extinguishing trail commission for legacy products, no 'immediate plans to bring forward proposals for policy change' were advanced.[108] The FCA argued that there was significant difficulty in removing trail commissions, specifically for advisers. The removal of trail commissions would hurt self-employed advisers 'who rely on trail commission for future income',[109] especially those who rely on payments for retirement income.[110] Furthermore, the trail commission constitutes 'an important element of the value of a business when an adviser retires or sells their business'.[111] A ban on trail commissions may disproportionately affect smaller advisory firms.[112] In their view, the FCA determined that there was no clear consumer harm evidenced to justify the elimination of trail commissions.[113] Some firms also fear that 'advisers will not recommend them for future clients if they unilaterally switch off trail commission'.[114]

The counterpoint is that the continued payment of trail commissions prevented some investors 'from receiving value for money', because advisers are 'reluctant to advise investors to switch away from products that pay trail commission'.[115] Moreover, 'ongoing charges for investments that pay trail commission payments

102 See, eg, ibid.
103 See *Financial Advice Market Review* (n 89) 6.
104 Planners1, 'Grandfathered Commissions: What are They?', *Wealth & Security Planners* (Web Page, 9 August 2018) <https://www.wsp.com.au/2018/08/09/grandfathered-commissions-what-are-they/>.
105 'Trail Commission', *Financial Conduct Authority* (Web Page, 18 April 2016) <https://www.fca.org.uk/consumers/trail-commission>.
106 Ibid.
107 Ibid.
108 Elliot Smith, 'FCA Sticks Pin in Pre-RDR Trail Commission Ban', *Wealth Manager* (Web Page, 5 April 2018) <https://citywire.co.uk/wealth-manager/news/fca-sticks-pin-in-pre-rdr-trail-commission-ban/a1107723>.
109 Ibid.
110 Financial Conduct Authority, *Consultation on Implementing Asset Management Market Study Remedies and Changes to Handboo*k (Consultation Paper No CP17/18, June 2017) 23 [4.18].
111 Elliot Smith (n 108).
112 Financial Conduct Authority, *Consultation on Implementing Asset Management Market Study Remedies and Changes to Handbook* (Consultation Paper No CP17/18, June 2017) 23 [4.18].
113 Elliot Smith (n 108)
114 Financial Conduct Authority, Consultation on Implementing Asset Management Market Study Remedies and Changes to Handbook (Consultation Paper No CP17/18, June 2017) 23 [4.17].
115 Ibid 20 [4.2].

are significantly higher compared to other classes'.[116] One report suggested that the 'ongoing charges for some pre-RDR share classes are 90% higher than for classes that do not pay trail commission for similar types of funds'.[117] Of surveyed firms, '31% of all UK-domiciled fund assets … remain in classes that can pay trail commission'.[118] Investors also may not necessarily receive service in return for continued trail commission payments, as 'advisers do not have to provide an ongoing service for the trail commission'.[119]

At this stage, the FCA has not 'taken steps to introduce an end date for trail commission', but 'may consider it in the future'.[120] The FCA has also provided advice to customers willing to stop or reduce the amount of trail commission consumers pay, including selling an investment, asking for better service and claiming the commission.[121]

In the context of the UK, the FCA is still 'considering the issue', with no 'immediate plans' for reform.[122] It seems that the urgency of this reform is contingent on an accurate conception of the prevalence of trail commissions. To the extent that pre-RDR share classes still comprise close to a third of fund assets,[123] the impact of trail commissions appears widespread enough that to refuse reform becomes principally inconsistent with the aims of the 2006 RDR. For many advisers, this disincentivises suitability and invigorates residual conflicted remuneration, as bias and self-interest become factors in the process of advice-giving.[124] To uphold the principled aims of transparency and trust advanced by recent reforms, trail commissions – and the sizable influence they continue to exert on the UK market – should therefore be reconsidered.

C The Suitability Rule and Its Requirements

MiFID II, effective in 2018, broadly confirms the importance of the suitability assessment as outlined in *MiFID I*,[125] but further expands on suitability obligations. Article 25(2) places a burden on firms to conduct an additional assessment of the client's 'risk tolerance and ability to bear losses';[126] this responsibility is not absolved by the use of electronic systems.[127] Moreover, firms are required to 'provide clients with a statement on suitability' – otherwise known

116 Ibid.
117 Ibid 22 [4.15].
118 Ibid 22 [4.12].
119 Ibid 22 [4.14].
120 Ibid 23 [4.19].
121 'Trail Commission', *Financial Conduct Authority* (Web Page, 18 April 2016) <https://www.fca.org.uk/consumers/trail-commission>.
122 Financial Conduct Authority, 'Asset Management Market Study Remedies and Changes to the Handbook: Feedback and Final Rules to CP17/18' (Policy Statement No PS18/8, April 2018) 16 [1.32].
123 Financial Conduct Authority, *Consultation on Implementing Asset Management Market Study Remedies and Changes to Handbook* (Consultation Paper No CP17/18, June 2017) 22 [4.12].
124 Ibid 20 [4.2].
125 European Securities and Markets Authority, *Guidelines on Certain Aspects of the MiFID II Suitability Requirements* (Final Report, 28 May 2018) 4.
126 *MiFID II* (n 22) art 25(2).
127 European Securities and Markets Authority, *Guidelines on Certain Aspects of the MiFID II Suitability Requirements* (Final Report, 28 May 2018) 4.

as the 'suitability report' – when providing a 'personal recommendation'.[128] The suitability requirements in *MiFID II* apply to investment services that provide investment advice or portfolio management to all clients.[129] The degree of suitability assessment, however, varies depending on which of the three client categories the client is classified as: retail clients require the greatest degree of assessment, followed by professional clients, then eligible counterparties. In regard to professional clients, the investment firm is entitled to assume the client 'has the necessary level of experience and knowledge' for the purposes of assessing suitability.[130]

The UK was, historically, obliged to implement *MiFID*.[131] Chapter 9A of the FCA's *COBS* specifically encapsulates all *MiFID II* suitability requirements, which go beyond the existing provisions in *COBS* 9. Chapter 9A places additional demands on firms to obtain the necessary information to make a suitability assessment and recommend investments accordingly.[132] These enhanced requirements particularly include periodic suitability assessments and periodic suitability reports.[133]

COBS 9.2.1R requires a firm to 'take reasonable steps to ensure that a personal recommendation … is suitable for its customer'.[134] COBS 9.2.2R further outlines several facets of a client's circumstances to be examined in the process of determining suitability for an individual client.[135] The requirement constitutes an assessment on the suitability of any recommended investment,[136] not only factoring in 'the risk a customer is willing to take', but also 'the client's capacity for loss and their objectives and circumstances'.[137] This holistic evaluation hence requires firms to consider both subjective preferences (eg, attitudes towards risk taking) and objective circumstances (eg, financial capacity to absorb risks).[138] The amalgamation of *COBS* 9.2.2R considerations can be summarised by the expression 'the risk a customer is willing and able to take'.[139] This necessitates the

128 Ibid.

129 *MiFID II* (n 22) art 25(2).

130 *Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 Supplementing Directive 2014/65/EU of the European Parliament and of the Council as Regards Organisational Requirements and Operating Conditions for Investment Firms and Defined Terms for the Purposes of that Directive* [2017] OJ L 87/1, art 54(3).

131 Financial Conduct Authority, *The MiFID 2 Guide* (Guide, October 2020) 1.1.2.

132 See generally Financial Conduct Authority, *Markets in Financial Instruments Directive II Implementation: Policy Statement II* (Policy Statement No PS17/14, July 2017) 85 ('*MiFID II Implementation*').

133 Taylor Wessing, *MiFID II User Guides* (Guide, 10 February 2017) 13.

134 Financial Services Authority, *Assessing Suitability: Establishing the Risk a Customer is Willing and Able to Take and Making a Suitable Investment Selection* (Finalised Guidance, March 2011) 2 [1.2] ('*Assessing Suitability*'), citing *COBS* (n 30) 9.2.1R.

135 Ibid 2 [1.2], citing *COBS* (n 30) 9.2.2R.

136 Financial Conduct Authority, *The Assessing Suitability Review: Results* (Report, May 2017) 8.

137 Mark Loosmore, 'The Suitability of Risk Assessment' (24 March 2011) *Professional Adviser* 25. See also 'Assessing Suitability', *Financial Conduct Authority* (Web Page, 6 March 2020) <https://www.fca.org.uk/firms/assessing-suitability>.

138 *Assessing Suitability* (n 134) 3 [1.8].

139 Ibid.

collection of specific details from clients to inform 'personal recommendations'.[140] Like *MiFID II*, COBS 9.4 also requires firms to 'provide a suitability report' if a retail client decides to 'take action as a result of this recommendation'.[141]

It is crucial to highlight that suitability is generally understood as situating somewhere between 'the two extremes on the spectrum running from "not suitable" to "positively and indisputably the most suitable available"'.[142] Implicitly, moreover, 'most suitable' is synonymous with 'best advice' – an explicit requirement which was severed as the FSA saw the concept of best advice as 'an intrinsic part of the new high-level principle – that an adviser's duty is to act in a client's best interests, alternatively known as the duty of loyalty'.[143] For the FSA, 'detailed prescribed rules had led to regulatory failures due to a "tick box" approach and a lack of holistic thinking'.[144] The FSA sought to remedy this through principles-based regulation which would apply broadly to firms,[145] although it also set forth a detailed plan for financial advisers to anchor their conduct.

These parallel obligations are operatively distinct. It is clear that the best interests duty in the UK context is framed as a high-level principle, backed up by detailed specifications in *COBS*: the 'overarching requirement … cannot be displaced by compliance with specific rules if the overarching requirement is breached'.[146]

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140 Robin Bowley, 'Regulating the Financial Advice Profession: An Examination of Recent Developments in Australia, New Zealand and the United Kingdom and Recommendations for Further Reform' (2017) 36(1) *University of Queensland Law Journal* 177, 184.

141 Ibid.

142 Martin Berkeley, 'Do the FCA's Principles for Business Require a Firm to Give the Best Advice?' (April 2018) *Butterworths Journal of International Banking and Financial Law* 246.

143 Ibid 246–7, citing Financial Services Authority, *Reforming Conduct of Business Regulation* (Consultation Paper No 6/19, October 2006) 77.

144 Berkeley (n 142) 247. See also, Julia Black, Martyn Hopper and Christa Band, 'Making a Success of Principles-Based Regulation' (2007) 1(3) *Law and Financial Markets Review* 191, 195, 198.

145 Berkeley (n 142) 247. Then-FSA Director Dan Waters stated that 'the move toward principles-based regulation means focusing on the outcomes that really matter rather than on procedural box-ticking': 'FSA Reforms Conduct of Business Rules', *Finextra* (online, 31 October 2006) <https://www.finextra.com/newsarticle/16092/fsa-reforms-conduct-of-business-rules>.

146 Berkeley (n 142) 247; *British Bankers Association v Financial Services Authority and Financial Ombudsman Service* [2011] EWHC 999 (Admin) [162]–[166] (Ouseley J) ('*BBA v FSA and FOS*'). In the UK, the FSA Handbook sets out high-level principles for the conduct of business, while the Insurance Conduct of Business ('ICOB') contains detailed rules about the sale of payment protection insurance ('PPI') policies: *BBA v FSA and FOS* [60], [97] (Ouseley J). The British Bankers Association ('BBA') challenged a policy statement introduced by the FSA to address the mis-selling of PPI policies; as the BBA saw it, the statement would treat certain procedural failings as breaches of the high-level principles even if the detailed ICOB rules had been adhered to: *BBA v FSA and FOS* [6], [48] (Ouseley J). It thus argued that the statement was unlawful because it treated the principles (as opposed to the ICOB rules) as giving rise to obligations owed by banks to customers, even though the principles were not actionable at law: *BBA v FSA and FOS* [7], [48] (Ouseley J). The objection failed: Ouseley J held that the principles are the overarching framework for FSA regulation or 'the ever present substrata to which the specific rules are added': *BBA v FSA and FOS* [162] (Ouseley J). The principles thus 'stand over the specific rules' and 'always have to be complied with'; the specific rules 'do not supplant them and cannot be used to contradict them': *BBA v FSA and FOS* [162], [166] (Ouseley J).

III REGULATING FINANCIAL ADVISERS IN AUSTRALIA AND ITS DISCONTENTS

A The Reforms

As mentioned earlier, in Australia, the 2012 FOFA reform package required 'providers of financial advice to act in the best interests of their clients'.[147] The reforms arose from a central issue: 'that conflicts of interest were pervasive and that conflicting advice was "manifesting" itself as "poor quality or inappropriate advice to consumers"'.[148] Criticism levelled against pre-existing consumer protections noted that the then framework was underscored by the false assumption that the efficiency of markets and transparency was a more significant objective than 'regulating the quality of financial products'.[149] Yet, this threshold was low enough 'to allow advice that favours the adviser's interests above those of the client's'.[150]

The best interests and related obligations are now contained in Part 7.7A, Chapter 7 of the *CA*, which regulates financial services and financial markets overall. Chapter 7 includes the general obligation to provide financial services '*efficiently*, *honestly* and *fairly*' in section 912A of the *CA* – similar to what is required in the UK/EU context, though the latter focuses more on 'professionally' rather than 'efficiently'.[151] Part 7.7 of the *CA* (sections 940A–953C) focuses on disclosure requirements for licensed financial advisers to retail clients and Part 7.7A (sections 960–8) expands on this with best interests and related obligations, as elaborated further below. In addition, the FOFA package contains the ban on conflicted remuneration and opt-in arrangements under which advice providers must renew their clients' agreement to ongoing fees every two years.[152] As detailed below, while the pre-FOFA suitability rule applied to the 'providing entity',[153] the FOFA reforms expand the best interests and related obligations to cover those who actually provide advice.[154]

147 Stephen Corones and Thomas Galloway, 'The Effectiveness of the Best Interests Duty: Enhancing Consumer Protection?' (2013) 41(1) *Australian Business Law Review* 5, 5–6. The *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2012* (Cth) sch 1 item 23 amended the *Corporations Act 2001* (Cth) to insert the 'best interests duty' at s 961B.

148 Corones and Galloway (n 147) 6. See also Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Inquiry into Financial Products and Services in Australia* (Report, November 2009) 74 [5.24] ('*Ripoll Report*').

149 Corones and Galloway (n 147) 12. See also Gail Pearson, 'Risk and the Consumer in Australian Financial Services Reform' (2006) 28(1) *Sydney Law Review* 99, 109-–10.

150 Corones and Galloway (n 147) 13, quoting *Ripoll Report* (n 148) 87 [5.74]. See also Industry Super Network, Submission No 380 to Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Inquiry into Financial Products and Services in Australia* (Report, November 2009) 17.

151 *Corporations Act 2001 (Cth)* s 912A(1)(a) (emphasis added); MiFID II (n X) art 24(1).

152 *Corporations Act 2001* (Cth) ss 962L–963K, 963E, 1528, 1531C as inserted by *Corporations Amendment (Future of Financial Advice) Act 2012* (Cth) sch 1 item 10, *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth) sch 1 item 33, *Corporations Amendment (Financial Advice Measures) Act 2016* (Cth) sch 1 item 21.

153 See (n 185).

154 *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth) sch 1 item 23.

B The Best Interests Obligation

Following the GFC, the Parliamentary Joint Committee ('PJC') on Corporations and Financial Services convened to inquire into the 'issues associated with recent financial product and services provider collapses', such as Storm Financial[155] and Opes Prime.[156] Chaired by Labor MP Bernie Ripoll, the Committee released its report in November 2009.[157] The Committee identified the following needs, among others:

(i) to improve the standard of advice to increase consumers' confidence, be it 'through enhanced legislative requirements about the standard of advice required or enhanced enforcement of existing standards, or both';

(ii) to 'better inform customers about the products they signed up for' so that consumers would only buy products that 'entail a comfortable level of risk'; and

(iii) 'to ensure that advisers are better informed about products being sold'.[158]

The PJC's recommendations included the creation of a statutory fiduciary duty for financial advisers.[159] This would require advisers to put the interests of clients before their own. In response, in April of 2010 the Labor government flagged the implementation of a mirror statutory fiduciary requirement.[160] Eventually, in 2012 the FOFA legislation was passed with a statutory best interests obligation and related obligations.[161]

Section 961B(1) of the *CA* requires an adviser to 'act in the best interests of the client in relation to the advice'. Without defining the concept of 'best interests', section 961B(2) goes on to state that advice providers may satisfy this duty if they have met particular safe harbour conditions, which can be summarised as:

- identifying the client's objectives, financial situation and needs;
- making reasonable inquiries to obtain complete and accurate information;

155 The collapse of Storm had a 'catastrophic' impact on its 3000 investment clients: *Ripoll Report* (n 148) 19 [3.1], 21 [3.12]. Storm used an aggressive strategy that encouraged people to take out loans against the equity in their own homes, and an investment model that was not capable of withstanding the severe market downturn in 2008: at 21 [3.12], 23 [3.22]. Issues highlighted by the *Ripoll Report* include one-size-fits-all advice, advisers strongly downplaying the risk of losing the family home, and poor management of margin calls: at 27 [3.33], 28–9 [3.39], 36 [3.70]–[3.72].

156 Opes Prime provided securities lending (cash collateral was given in exchange for a client transferring title in securities), with clients' securities sold down when Opes was put into administration: *Ripoll Report* (n 148) 53 [4.14], 54 [4.19]. Issues identified in the *Ripoll Report* included ineffective disclosure to clients that ownership in their shares would be passed to Opes, and the inappropriate provision of a sophisticated product to retail investors (this type of lending agreement was designed for use by corporate investors operating in wholesale markets): at 65 [4.66], 66 [4.72].

157 Ripoll Report (n 148).

158 Ibid 30 [3.44].

159 Ibid 103 [6.2].

160 The Treasury (Cth), 'Overhaul of Financial Advice' (Media Release, 26 April 2010). This reference includes the details of the announcement of the FOFA reforms and the 'introduction of a statutory fiduciary duty'.

161 *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth); *Corporations Amendment (Future of Financial Advice) Act 2012* (Cth).

- assessing whether it has the required expertise to advise on the subject matter;
- conducting a reasonable investigation into the relevant financial products;
- basing all judgments on the client's relevant circumstances; and
- taking 'any other step … that would reasonably be regarded as being in the best interests of the client'.[162]

In essence, these provisions – including assessments of the circumstances of the client and whether or not steps have been taken to obtain complete information – feature similar obligations imposed under the suitability rule of *COBS* in the UK.[163]

Section 961B of the *CA* imposes a statutory duty that frames the obligation as 'a standard of conduct' necessitating positive steps for compliance. The effect of this is to shift the regulatory focus 'onto the conduct of advice providers, rather than their motivations' – the latter of which is addressed through the ban on conflicted remuneration.[164] Notably, the question of compliance is rendered significantly unclear by the lack of an explicit definition of 'best interests' in the legislation.[165]

The Australian Securities and Investments Commission's ('ASIC') interpretation of the best interests duty is a determination of whether or not consumers are left in a 'better position' if advice is followed.[166] This is a circumstantial assessment, including an examination of factors such as 'the position the client would have been in if they did not follow the advice', 'the facts at the time the advice is provided', 'the subject matter of the advice', and 'the client's objectives, financial situation and needs'.[167] While 'perfect advice' is not expected, the client must nevertheless be left in a better position.[168] Critique has been levelled at this standard as the concept of a 'better' result is ambiguous and the client may enjoy a better result regardless of whether or not the best interests obligation is satisfied.[169]

Commentators have criticised the elements of the best interests duty found in section 961B(2) of the *CA*. Criticism centres on it providing an incentive for financial advisers to focus on ticking boxes, instead of the substance or principles of their advice.[170] While the 'catch-all' provision in section 961B(2)(g) can moderate this concern, it also attracts criticisms because of its open-ended nature.

162 *Corporations Act 2001* (Cth) s 961B(2)(a), (c), (g).
163 Ibid s 961B; cf *COBS* (n 30) 2.1.1R, 9.2, 9A.
164 Corones and Galloway (n 147) 17.
165 Ibid 24.
166 Australian Securities & Investments Commission, *Licensing: Financial Product Advisers* (Regulatory Guide No 175, November 2017) 65 [RG 175.244].
167 Ibid [RG 175.246].
168 Ibid 66 [RG 175.247].
169 Matthew Daley and Samantha Carroll, 'Are You FOFA Ready? The Best Interests Duty: What is Appropriate?', *Clayton Utz* (Web Page, 14 February 2013) <https://www.claytonutz.com/knowledge/2013/february/are-you-fofa-ready-the-best-interests-duty-what-is-appropriate>.
170 See, eg, Gerard Craddock, 'The Ripoll Committee Recommendation for a Fiduciary Duty in the Broader Regulatory Context' (2012) 30(4) *Company and Securities Law Journal* 216, 236.

The Law Council of Australia suggested this clause would potentially create uncertainty around the exact norms of behaviour required by the law.[171] Conversely, the Treasury indicated that section 961B(2)(g) was designed to discourage the 'tick-a-box' attitude that may otherwise be fostered by the safe harbour clause, highlighting the new law must balance competing interests.[172] Similarly, ASIC argued for the inclusion of section 961(2)(g) to meet the policy objective to improve the quality of advice, stating:

> The stark choice I am drawing is whether or not you want a tick-a-box approach, which you really get very close to if the provision in (g) is removed, or whether you want to transform this into a profession and have people exercising particular judgment in particular cases as other professionals do.[173]

It is crucial to note that although some would argue that the best interests duty is equivalent to a general law fiduciary obligation, the legislative history seems to suggest otherwise.[174]

Relatedly, the 'Design and Distribution Obligations' regime commencing in 2021 uses similar language in regulating issuers and distributors of financial products.[175] It must be reasonable to conclude that if a product were issued or sold, it would 'be consistent with the likely objectives, financial situations and needs of persons in the target market'.[176] Most of the obligations will not apply to the provision of personal advice; as such conduct is already subject to the best interests duty, the obligations introduced (eg, the obligation to take reasonable steps to that distribution is consistent with the target market determination)[177] would have no further effect.[178] However, two new obligations will apply: record-keeping provisions require all regulated persons to keep complete and accurate records of 'distribution information' (such as target market information), while notification provisions require regulated persons to notify a product's issuer of 'significant dealings' that are not consistent with the product's target market determination.[179]

Besides the above requirements, financial advisers must comply with a mandatory Code of Ethics, effective from 1 January 2020.[180] This introduced

171 'Chapter 4: Views on the Introduction of a Statutory "Best Interests" Duty for Financial Advisers' *Parliament of Australia* (Web Page) [4.23] <https://www.aph.gov.au/parliamentary_business/committees/joint/corporations_and_financial_services/completed_inquiries/2010-13/future_fin_advice/report/c04>.

172 Ibid [4.26].

173 Ibid [4.28].

174 The *Ripoll Report* recommended a fiduciary duty requiring financial advisers to place the interests of the clients ahead of their own: *Ripoll Report* (n 148) 110 [6.28]. However, the government did not use the word 'fiduciary' in the subsequent draft legislation and section 961B imposes prescriptive rather than proscriptive obligations on providers of financial advice: Exposure Draft (Tranche 1), *Corporations Amendment (Future of Financial Advice) Bill 2011* (Cth) s 961C; see also Corones and Galloway (n 147) 16.

175 *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* (Cth); Revised Explanatory Memorandum, Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019 (Cth) 18 [1.58].

176 Ibid (emphasis omitted).

177 Ibid 26 [1.93].

178 Ibid 24 [1.84].

179 Ibid 29 [1.106]–[1.110], 31 [1.113]–[1.116].

180 *Corporations Act 2001* (Cth) s 921E.

twelve high-level ethical standards to be met by advisers, such as maintaining a high level of knowledge and skills,[181] and ensuring that clients give informed consent and understand the advice received.[182]

1 Usage of Restricted Terms

Section 923A of the *CA* restricts a person from using certain words and expressions, such as 'independent', 'impartial' and 'unbiased' unless certain requirements are met.[183] Among others, the key requirement is that the person (or anyone providing financial services on their behalf) does not receive commissions, volume-based remuneration from the issuer, or other gifts or benefits from product issuers that may reasonably be expected to influence that person.[184] Moreover, that such person should be free from conflicts of interest that might 'arise from their associations or relationships with issuers of financial products' and which might 'reasonably be expected to influence the person'.[185]

Commissioner Hayne's report refers to these notions of 'independent advice' and 'restricted advice' coined in the UK, and he held the view that a financial adviser who does not meet requirements under section 923A(1) *CA* should be required to inform the client of the fact that they do not meet these requirements, and explain, 'prominently, clearly and concisely' why that is the case.[186] Some of his recommendations have, as noted below, been addressed in the recently proposed reform package.

2 Abolition of Conflicted Remuneration

The second FOFA Bill, the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (Cth), introduced the ban on conflicted remuneration by prohibiting the payment and receipt of certain remuneration which could influence the advice that licensees provide to consumers in relation to financial product advice.[187] The policy intent behind this ban was to shift the financial advice industry from a commission-based model to a fee-for-service model, and to 'improve the integrity and professionalism of the industry and

181 Financial Adviser Standards and Ethics Authority, *Financial Planners and Advisers Code of Ethics 2019* (at 8 February 2019) Standard 10.

182 Ibid Standards 4 and 5. Another notable development is that the government has acted on Commissioner Hayne's Recommendation 1.2 and passed the new legislation imposing the "best interests duty" onto mortgage brokers: *Final Report* (n 9) 20 [3.1]; *Financial Sector Reform (Hayne Royal Commission Response: Protecting Consumers (2019 Measures)) Act 2020* (Cth) s 158K.

183 Likewise, the ASIC makes clear that expressions such as 'independently owned', 'non-aligned' and 'noninstitutionally owned', and other similar ones, are also restricted and can only be used if the conditions of s 923A are met: Australian Securities & Investments Commission, *Licensing: Financial Product Advisers: Conduct and Disclosure* (Regulatory Guide No 175, November 2017) [RG 175.70].

184 Australian Securities & Investments Commission, *Licensing: Financial Product Advisers: Conduct and Disclosure* (Regulatory Guide No 175, November 2017) [RG 175.64].

185 *Corporations Act 2001* (Cth) s 923A(2)(e).

186 *Final Report* (n 9) 173, 176.

187 Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (Cth) ss 963A, 963E.

increase[e] consumer confidence in financial planners'.[188] However, the Coalition Government, then in opposition, circumvented this ban by inserting grandfathering provisions.[189] These provisions excluded certain arrangements made before the FOFA reforms came into force in 2013 that would have otherwise fallen within the ban on conflicted remuneration, from the definition of conflicted remuneration.[190] The justification for limiting the retrospective operation of the ban was to 'recognise and preserve existing and long standing property rights'.[191] The Labor government agreed to these concessions, thus permitting the payment and receipt of some forms of conflicted remuneration for financial advice to continue under 'grandfathering provisions' made by subdivision 5 of division 4, part 7.7A of the *Corporations Regulations 2001* (Cth).[192] As mentioned earlier, such a grandfathering provision is a source of controversy, with the Commissioner therefore recommending its repeal.[193] A recently passed Act is set to abolish the grandfathering provision, which we turn to discuss in Part IV below.[194]

C The Appropriateness Rule

First introduced as section 191 of the *Companies and Securities Legislation (Miscellaneous Amendments) Act 1985* (Cth), the suitability rule, also known as 'know-your-client' ('KYC') rule, had been the cornerstone governing financial advisers in Australia.[195] Section 191 required AFSL holders or their authorised representatives – referred to as 'providing entities' – to comply with the suitability rule in giving personal advice to retail clients. As Edelman J expounded in *Australian Securities and Investments Commission v Cassimatis (No 8)*, a landmark pre-FOFA case, the purpose of the suitability rule was to ensure financial advice was suitable for the client and had a reasonable basis.[196] Specifically, the suitability rule imposed three obligations on financial services licence holders (not individual advisers) that are separate but interrelated:[197] firstly, there was an

188 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* (Report, February 20312) 66 [5.13], 68 [5.21]

189 See Boyce et al, 'Dissenting Report by Coalition Members of the Committee', *Parliament of Australia* (Web Page) <https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Completed_inquiries/2010-13/future_fin_advice/report/d01>.

190 Ibid 15.

191 Ibid.

192 *Corporations Regulations 2001* (Cth) regs 7.7A.15B–7.7A.16F; *Corporations Act 2001* (Cth) s 1528.

193 See *Final Report* (n 9).

194 *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Act 2019* (Cth).

195 For a detailed account of the background, see Andrew J Serpell, 'Re-evaluating the Appropriate Advice Rule in Light of The Global Financial Crisis' (2009) 4(2) *University of New England Law Journal* 33, 34.

196 *Australian Securities and Investments Commission v Cassimatis (No 8)* (2016) 336 ALR 209.

197 That is, if the providing entity: (i) determines the relevant personal circumstances in relation to giving that advice and makes reasonable inquiries in relation to those personal circumstances; (ii) has given consideration to, and conducted such investigation of, the subject matter of the advice as is reasonable in all of the circumstances, having regard to information received from the client concerning those personal circumstances; and (iii) the advice is appropriate to the client, having regard to that consideration and investigation: *Corporations Act 2001* (Cth) ss 945A–945B, as repealed by *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth) s 9.

obligation under section 945A(1)(a) to assess the client's relevant personal circumstances before giving the advice; secondly, there was an obligation under section 945A(1)(b) to consider and investigate the subject matter of the advice; finally, there was an obligation under section 945A(1)(c) to ensure that the advice is appropriate to the client having regard to that consideration and investigation.

In the pre-FOFA era, empirical evidence showed widespread non-compliance under the section 945A rule. ASIC reviewed examples of advice under section 945A and found that while 58% of examples were adequate, '39% of the advice examples were poor, and two examples were good quality advice (3%)'.[198] The same study found that in 54 of 64 cases, the advisers' recommendations were 'tailored to their clients' circumstances'.[199] ASIC also found that the quality of advice under the then section 945A did not meet consumers' expectations and failed to ensure that advice was given in the clients' interests.[200]

As it stands, section 961G requires advisers to 'only provide the advice … if it would be reasonable to conclude that the advice is appropriate to the client'.[201] As explained in the Explanatory Memorandum, section 961G mimics the requirement for advice to be appropriate to the client under the suitability rule, and the process-related elements forming this requirement have been included in the steps of the new best interests obligations found in section 961B(2).[202] Financial advisers are required under section 961H, moreover, to warn their clients about the appropriateness of the advice if 'it is reasonably apparent that information relating to the objectives, financial situation and needs of the client on which the advice is based is incomplete or inaccurate'.[203]

Moreover, the appropriate advice rule may need to be re-evaluated against relevant financial contexts in order to operate effectively. An example of this is the Global Financial Crisis, in which consumers are much more likely to seek financial advice in making critical financial decisions such as 'whether to change investment strategy', 'whether to sell any financial products' and 'whether to invest money in "safe" products'.[204] This may suggest that the appropriate advice rule did not effectively respond to the needs of consumers in times of crisis. One argument is that the rule ought to be relaxed so that advisers feel more comfortable communicating advice during times of crisis; Serpell argues, for instance, that the

198 Australian Securities & Investments Commission, *Shadow Shopping Study of Retirement Advice* (Report No 279, March 2012) 8 [18].

199 Ibid 41 [143].

200 Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Inquiry into Financial Products and Services in Australia* (Report, November 2009) 85–6, citing Australian Securities and Investments Commission, Submission No 370 to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Financial Products and Services in Australia* (August 2009) 6.

201 *Corporations Act 2001* (Cth) s 961G, as inserted by *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth) sch 1 item 23.

202 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, 16–17.

203 *Corporations Act 2001* (Cth) s 961H(1), as inserted by *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth) sch 1 item 23.

204 Andrew J Serpell, 'Re-evaluating the Appropriate Advice Rule in Light of the Global Financial Crisis' (2009) 4(2) *University of New England Law Journal* 33, 34.

'definition of "personal advice" is too broad' and may inhibit issuers and advisers from communicating with their clients 'due to concerns … about the potential breadth of the definition of "personal advice"'.[205] An alternative interpretation is that the rule ought to be strengthened in such times to be effective – as consumers are likely to be particularly susceptible to acting on inappropriate financial advice in precisely these desperate contexts. This analysis would demand an assessment of the costs of consumers not receiving advice compared to the cost of consumers receiving poor advice. Arguably, if consumers will pursue advice in either case, it is better that rigid standards are observed in order for the regulatory regime to effectively ensure compliance and prevent loss. At the time, the appropriate advice rule broadly failed to address the needs of consumers.

IV POST-ROYAL COMMISSION DEVELOPMENT AND LESSONS FROM THE UK

Built upon our analysis above, we can draw the following points to shed light on the future reform in Australia. First and foremost, while neither the UK/EU nor Australia explicitly define the term 'best interests duty', it is clear that the way in which the UK/EU conceptualise it is much wider than its Australian counterpart. In the UK, the best interests duty is framed by *COBS* as broadly addressing various aspects of financial advisers' conduct.[206] By contrast, in Australia, the best interests duty is determined narrowly against the parameters of the safe harbour provision.[207] In other words, the UK's best interests duty functions as a high-level principle, while, in Australia, the safe harbour provision – as Commissioner Hayne remarked[208] – features some sort of 'box-ticking' exercise.[209] *COBS* 2.1.1R is an overarching high-level principle that applies generally to firms. Hence, the general 'umbrella' duty of *COBS* 2.1.1R is, by nature, 'overarching', but lacks interpretive specificity.[210] It is a high-level principle used to assist in guiding firms and their objectives, but arguably is interpreted according to 'its specific elements in the legislation dealing with particular conduct'.[211]

A related, and more intriguing point derives from the comparison between section 961B and 961G of the *CA* and the UK's suitability rule. The notion of the appropriateness duty is, as revealed in legislative history, comparable to the suitability rule in the UK. The requirements under the safe harbour provision are somewhat similar to what is required under the suitability rule in the UK.[212] For

205 Ibid 38.
206 *COBS* (n 30) 2.1.1R.
207 *Corporations Act 2001* (Cth) s 961B.
208 *Final Report* (n 9) 496.
209 *Corportions Act 2001* (Cth) s 961B; Berkeley (n 142) 246.
210 *BBA v FSA* [2011] EWHC 999 (Admin) [166] (Ouseley J).
211 Iris HY Chiu and Alan H Brener, 'Articulating the Gaps in Financial Consumer Protection and Policy Choices for the Financial Conduct Authority: Moving Beyond the Question of Imposing a Duty of Care' 14(2) *Capital Markets Law Journal* 217, 227, citing Busch, 'MiFID II: Stricter Conduct of Business Rules for Investment Firms' (n 54) 340.
212 Ibid 227–8.

example, in the safe harbour provision, there are further requirements on what is considered as 'reasonably apparent,' 'reasonable investigation', and 'reasonably', elaborating on the elements in the safe harbour provisions.[213] In this light, the 'best interests duty' is met as long as the safe harbour requirements are satisfied. In the UK, without similar safe harbour provisions in place, what is considered as fulfilling the best interests duty is dependent on the facts and circumstances of a particular case.[214] In a sense, the best interest rule in the Australian context is much narrower than that in the UK context. Looking at it another way, in the UK, the suitability rule (and its detailed requirements) is just one among other tools to achieve the overarching 'best interests duty', while in Australia, those specific requirements under the safe harbour provision seem the only tool – subject to interpretation of the 'catch-all' provision[215] – to satisfy the best interests duty. This may explain the concerns around the 'box-ticking' exercise underscored by the Commissioner and other commentators.

Third, and more significantly, while the appropriateness duty would serve similar functions as the UK's suitability rule, the Australian counterpart lacks a central theme. A close examination of the suitability rule in the UK reveals that it places greater emphasis on clients' 'risk preference' and 'risk tolerance'. In assessing suitability, under *COBS* 9.2.2R(1), a firm must obtain information to ensure that the advice 'a) meets his investment objectives, b) is such that his able financially to bear any related investment risks consistent with his investment objectives; and c) is such that he has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio'. The information required also must include the client's risk preferences and his risk profile, as well as complexity and the risks of the product/investment.[216] In Australia, subject to section 961B, under section 961G of the *CA*, the advice can be provided if it would be 'reasonable to conclude that the advice is appropriate to the client'. There is no further requirement on what is considered to be 'reasonable'.

Another interesting point is that the UK model seems to feature a more interventionist or paternalistic approach compared to its Australian counterpart. For instance, in the UK, where information is insufficient or incomplete, no recommendation should be made to the client.[217] In Australia, by contrast, when information is incomplete or inaccurate, the advice could still be given as long as the client is warned.[218] Moreover, while the design of the safe harbour provision

213 *Corporations Act 2001 (Cth)* ss 961B(2)(c), (e), (i), (g).

214 *COBS* (n 30) 9.2.2R.

215 *Final Report* (n 9) 167, citing *Corporations Act 2001* (Cth) s 961B(2)(g).

216 *COBS* (n 30) 9.2.2R(2), 9.2.3R.

217 Ibid 9.2.6R; see also *COBS* 9.2.5R.

218 *Corporations Act 2001* (Cth) s 961H, as inserted by *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth) sch 1 item 23.

indicates that the best interests duty is a one-off obligation in Australia,[219] the UK suitability rule appears to be a continuing obligation in some occasions.[220]

In response to the findings of the Commission, there are reforms on the horizon. Under the current Coalition government, a ban on grandfathered commissions was justified to ensure that clients were not entrenched in older products – Treasurer Josh Frydenberg once stated that 'the government's reform will benefit retail clients as they will receive higher-quality advice and stop paying higher fees to fund grandfathered conflicted remuneration'.[221] Yet, industry stakeholders cautioned the government to 'avoid unintended consequences from rushed implementation on complex financial issues'.[222] Some of these reform proposals are noteworthy.

First, Commissioner Hayne recommended in the *Final Report* that the government should, in three years' time, review the effectiveness of the measures implemented to improve the quality of financial advice (such review to be completed no later than 31 December 2022).[223] The review should consider, inter alia, the necessity of retaining the 'safe harbour' clause in section 961B(2), with the Commission recommending repeal unless there is a clear justification.[224] Commissioner Hayne, moreover, indicated his preference over the principle-based approach, explicitly rejecting the option of 'amend[ing] the provision to be more prescriptive about how an adviser must pursue the client's best interests'.[225]

While the Commissioner's recommendations have their merits, we nevertheless caution that there may be unintended ramifications if Australia abolishes the safe harbour provision altogether. One obvious problem, as we have argued elsewhere,[226] is that financial advisers may find it problematic to comply with the best interests duty. The safe harbour provision, for instance, has been applied by the Federal Court in recent cases – notably, *Australian Securities and Investments Commission v NSG Services Pty Ltd*,[227] *Australian Securities and*

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219 *Corporations Act 2001* (Cth) s 961B(2)(g) requires that financial advisers must take any other step that, '*at the time the advice is provided*, would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances' (emphasis added).

220 *COBS* (n 30) 9A.3.3EU: 'Investment firms shall draw clients' attention to and shall include in the suitability report information on whether the recommended services or instruments are likely to require the retail client to seek a periodic review of their arrangements'.

221 John Kehoe, 'Grandfathered Commissions Face the Chop', *Australian Financial Review* (online, 30 July 2019) <https://www.afr.com/companies/financial-services/grandfathered-commissions-face-the-chop-20190730-p52c6z>. Please also note that the *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Act 2019* (Cth), which was passed in October 2019, requires grandfather commission arrangements to end as of 1 January 2021.

222 Kehoe (n 221).

223 See *Final Report* (n 9) 26.

224 Ibid.

225 Ibid 177.

226 See Liu et al (n 4).

227 (2017) 122 ACSR 47. NSG representatives failed to comply with ss 961B (best interest) and 961G (appropriate advice) in relation to advice provided to multiple clients, with NSG thus contravening s 961K(2): at 62 [76] (Moshinsky J). NSG also failed to take reasonable steps to ensure that its representatives complied with ss 961B and 961G, thereby contravening s 961L: at 62–3 [76] (Moshinsky J). ASIC sought pecuniary penalties in respect of these two contraventions: at 48 [5] (Moshinsky J).

Investments Commission v Wealth & Risk Management Pty Ltd (No 2),[228] and *Australian Securities and Investments Commission v Financial Circle Pty Ltd* (‘*ASIC v Financial Circle*’),[229] as a proxy to determine whether the best interests duty is satisfied. It would be difficult, as a matter of practice, for financial advisers to anchor their behaviour if we abolish the safe harbour provision without giving concrete, operative guidance.[230] Also, it is clear that while the UK generally follows the principle-based approach, the FCA nevertheless sets forth a set of very detailed instructions to guide their financial advisers. Thus, we argue that while the Australian government should follow the principle-based approach, clear instructions must be given.

One way to address these issues is to reconsider the function of the best interests duty. We submit that Australia should reconsider its ‘gatekeeping’ role of the best interests duty as an overarching principle – as has been done in the UK/EU context.[231] Such an overarching principle should be an open-ended principle: what is considered as best interest should depend on the facts and circumstances. It should not and cannot be, as is currently the case, easily satisfied through the safe harbour provision – despite the fact that the catch-all clause may require more than the box-ticking exercise. Rather, we should refer to the UK model, recasting the best interests duty as an overarching principle and removing the safe harbour provision. At the same time, similar to the UK's approach, further requirements should be developed to help financial advisers implement and comply with the appropriateness rule. As noted above, the appropriate advice duty is essentially premised on the notion of ‘suitability’.[232] It is suggested to fine-tune what constitutes ‘suitability’ by adding specific steps in section 961G of the *CA*. To that end, the elements under the current safe harbour provision can help achieve the purpose of ‘appropriate advice duty’. They may be considered to be included under section 961G of the *CA*. On top of that, more crucially, these detailed steps should be set to address the concerns around ‘risks’. As mentioned, the UK's suitability rule is concerned not so much with processes as with the provision of suitable

228 (2018) 124 ACSR 351. Expert analysis of 50 client files showed that Wealth & Risk Management's (‘WRM’) authorised representatives had breached s 961B in each one, as supported by consideration of the safe harbour requirements: at 365 [61]–[62] (Moshinsky J). WRM thus contravened s 961L of the *Corporations Act* by failing to take reasonable steps to ensure that its authorised representative complied with s 961B (as well as ss 961G and 961J) of the *Corporations Act*: at 372 [110]–[113] (Moshinsky J). An injunction was ordered to restrain the defendant from carrying on a financial services business or providing product advice for 18 years: at 384 [175] (Moshinsky J). A pecuniary penalty of $1,000,000 was also ordered in respect of the s 961L breach: at 385 [175] (Moshinsky J).

229 (2018) 131 ASCR 484. Review of 12 client files demonstrated that ‘in every case, the Financial Circle Adviser did not act in the client's best interest’: at 509 [131] (O'Callaghan J). This was evidenced by an expert report which found that advice fell short of the safe harbour requirements in s 961B(2): at 509 [130]–[131] (O'Callaghan J). Given its Adviser's breach of ss 961B (best interests), 961G (appropriate advice) and 961J (conflicts of interest), it was held that Financial Circle failed to take reasonable steps to ensure that its representatives complied with these sections: at 523 [215]–[216], 528–9 [236] (O'Callaghan J). Financial Circle thus contravened s 961L: at 523 [216], 529 [236] (O'Callaghan J). Penalties included permanent disqualification and a pecuniary penalty of $1,000,000 in respect of the s 961L contravention: at 529–30 [216] (O'Callaghan J).

230 Liu et al (n 4) 59–60.

231 Berkeley (n 142) 247.

232 See above Part III(C).

advice that reflects the client's risk preference and risk tolerance. The 'risk-based' focus is therefore a primary criterion against which financial advisers should measure business conduct – as some Australian financial advisers have done in practice.[233] In doing so, the interests of different stakeholders are better balanced. On the one hand, the best interests duty sets out the fundamental principle with which financial advisers should comply. On the other, the appropriateness rule helps financial advisers to better anchor their conduct through providing appropriate advice, bearing in mind the client's risk preference and capacity to absorb risks. In doing so, consumer interests are protected by the 'best interests duty', while the appropriateness rule gives more operative guidance to financial advisers to anchor their conduct in practice.

Second, and equally important issue on the reform agenda is how to address conflicts of interest given the vertically integrated financial conglomerate in Australia's financial market. As discussed by the Royal Commission and ASIC, it is common to see financial advisers recommend their in-house products, even though there are plenty of other, external products that may also be available on the market.[234] Such a practice, in Commissioner Hayne's view, shows that financial advisers seem to 'have prioritised their own interests – or those of a related party of the adviser – over the customer's interests, in breach of section 961J of the *Corporations Act*'.[235] The UK approach that strictly distinguishes between 'independent' and 'non-independent' advice is helpful to address such concerns. To be fair, there are already comparable mechanisms in the Australian context – notably, the use of restricted terms under section 923A of the *CA*. What we therefore need here is to fine-tune, rather than to overhaul, the existing framework in this regard. Currently, the Australian government has acted o Commissioner Hayne's recommendation 2.2,[236] requiring financial advisers to make clear to clients whether they satisfy the independent requirement under section 923A of the *CA*. While the basic requirements of section 923A of the *CA* remain the same, the draft bill requires that if a financial adviser would otherwise contravene section 923A by using a restricted word such as 'independent', 'impartial' and 'unbiased', they must give clients a written statement (in a form prescribed by ASIC) that discloses their lack of independence before providing personal advice, as well as include equivalent information in the Financial Services

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233 Indeed, a client's risk profile is part of the factors considered by financial advisers in practice. However, such a requirement is not clearly spelled out under the best interests duty or the safe harbour provision. For an industry view, see, eg, HUB24, 'The Adviser's Best Interests Duty: Creating Better Advice' (Research Paper, January 2019) <https://www.hub24.com.au/wp-content/uploads/2019/01/The-Advisers-Best-Interests-Duty-Creating-better-advice.pdf> (reporting that '[b]y far the most important issue in Best Interests Duty compliance when considering an investment product is whether or not the product matches the client's risk tolerance, assessed using a risk-profiling tool. Consideration of the client's tax position is ranked much lower': at 8).

234 *Final Report* (n 9) 168, citing Australian Securities & Investments Commission, *Financial Advice: Vertically Integrated Institutions and Conflicts of Interest* (Report No 562, January 2018) 28.

235 *Final Report* (n 9) 169, quoting Australian Securities & Investments Commission, *Financial Advice: Vertically Integrated Institutions and Conflicts of Interest* (Report No 562, January 2018) 42 [179].

236 Final Report (n 9) 176.

Guide.[237] Although the proposed change is somewhat different from the UK model,[238] this new approach would presumably serve the same purpose by further eliminating the conflicts of interest arising from vertical integrated structure in the Australian financial market.

The Australian government has, additionally, reacted to the Royal Commission's report by abolishing the 'grandfathering provision'.[239] Under the proposed legislation, grandfathered conflicted remuneration will be banned from 1 January 2021 and product issuers will be required to rebate the amounts to consumers.[240] Such a measure can help further improve the quality of advice by reducing the misaligned interests.

V CONCLUDING REMARKS

The reforms in the UK appear to have been relatively successful in gaining public trust in financial advisers, as compared to that of Australia. Industry lobbying led to a watering down of the FOFA reforms, giving rise to certain loopholes such as the grandfathering provision. Over the years, the circumstances deteriorated in Australia to a point where, together with the misconduct of the banks and the financial industry more generally, the government could no longer resist calls for holding a Royal Commission into the banking and financial system. The Royal Commission was scathing in its rebuke of the financial system's dealings with consumers and recommended widespread reforms, including cracking down on commission-based financial advisory services and more importantly, exploring ways to eliminate, rather than manage, conflicts of interests.[241]

Although it may be too early to predict whether and how the government and Parliament will react to Commissioner Hayne's recommendations in terms of the best interests duty and the appropriateness rule, some broader points can be drawn here. First, it is clear that the best interests duty is framed in the UK/EU as an overarching principle broadly governing various aspects of financial advisers' conduct. By contrast, although the best interests duty under section 961B(1) of the *CA* is like its UK counterpart, the safe harbour provision makes it too easy for financial advisers to comply without genuinely considering what is the best interests of the client. We agree with Commissioner Hayne's view that the safe harbour provision, in its current form, could operate as a 'box-ticking' exercise and should hence be amended. We caution, nevertheless, that removing safe harbour provision without further developing the appropriateness rule could create

237 The Financial Sector Reform (Hayne Royal Commission Response No. 2) Bill 2020 was passed in the Senate on 25 February 2021. It received Royal Assent on 2 March 2021 and will be law from 1 July 2021.

238 Explanatory Notes, Financial Sector Reform (Hayne Royal Commission Response: Protecting Consumers (2020 Measures)) Bill 2020 (Cth).

239 *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Act 2019* (Cth).

240 Ibid sch 1 pt 1.

241 *Final Report* (n 9) 3.

more problems than it solves. As such, we suggest that one option is to make clear what is required to achieve the 'appropriate advice' duty. As emphasised, 'risks' should be the cornerstone for financial advisers to meet this duty by giving suitable recommendations. Other mechanisms, such as the distinction between 'independent' and 'non-independent' advice in the UK, have been somewhat reflected in the most recently proposed bill, though it remains to be seen how these tools play out in practice. Last but not least, we must acknowledge that Australia does have many comparable 'law in books' mechanisms already: best interests duty, appropriate advice duty, use of restricted terms, etc. What we have to do next is, borrowing from the UK, further fine-tune these existing mechanisms. Of course, law in books is one thing; how to implement and enforce the law is another. There are also a number of gaps in our research and knowledge that follow from our law in books findings and would benefit from further research including the regulatory approach on the part of the regulator and the judiciary's role in giving effect to the rules identified above.