

Best Interest Duty

The best interest duty is the foundation of the FoFA reforms with the potential to deliver on the Government's aim to elevate the advice industry into a profession. The FSC believes it is critical that the industry have an opportunity to assess and comment on any revised drafting of the duty before it is tabled in Parliament given the significance it will have on the ability for the advice industry to continue to operate.

The FSC has made numerous submissions to Treasury regarding the significance of this duty. Specifically the FSC has advocated the introduction of a defined 'best interests duty' (to mean that a financial adviser must act in the best interests of their client and to give priority to the interests of the client in the event of a conflict of interest). A defined duty would provide consumers and advisers with certainty and not leave the task of defining the duty to the courts.

Further, we note that both Government announcements in April 2010 and April 2011 stipulated that the best interest duty would include "a reasonable steps qualification, so that advisers are only required to take reasonable steps to discharge the duty"¹.

Defence

Notwithstanding this, the draft legislation issued in Tranche 1 in late August and in discussions now with Treasury (3 November 2011), does not provide a definition of the duty nor provide a reasonable steps defence, it includes a number of conduct requirements (but not limited to those steps), establishes a duty of priority and requires that advisers provide appropriate advice. Without a defined best interest duty, advisers can still meet all other obligations established at law (in terms of conduct, priority and appropriateness of advice) and remain open to pernicious and/or vexatious law suits.

Without a defined duty and unlimited conduct steps, Professional Indemnity (PI) insurers will become more cautious and remain so while the new duty is tested in the courts. During this time the costs of PI cover will remain high (higher than current costs) thereby increasing the cost of advice for Australians and making it more difficult for non-aligned or salaried advisers to operate.

We re-iterate that a reasonable steps defence is not about limiting the adviser's best interest duty (at the expense of their client). Nor is any reasonable steps defence intended to allow contracting out of the best interest duty.

Preferred Option

The FSC notes that Treasury is seeking to accommodate industry concerns through the insertion of the following text into sections 961C(1) and (2):

'[the provider must act]in a way that could reasonably be regarded as [in the best interests of the client]'

¹ Future of Financial Advice, Information Pack 28 April 2011, page 12

However, the FSC's preference remains for a proper defence that reads as follows:

Subdivision H — Defences

- 961T** (1) It is a defence to any action brought against a provider in respect of an alleged breach of section 961C(1) if:
- (a) the provider has carried out the steps referred to in section 961C(2); and
 - (b) having regard to the circumstances existing at the time of the provision of the advice, it is reasonable to believe that the provider acted in the best interests of the client when giving the advice.
- (2) It is a defence to any action brought against a provider in respect of an alleged breach of section 961K or section 961L if having regard to the circumstances existing at the time of the provision of the advice, it is reasonable to believe that the provider gave priority to the interests of the client when giving the advice.
- (3) For the purposes of section 961T and this Part 7.7A generally, instructions of a client refers to the instructions given to the provider by the client in relation to the scope, subject matter and nature of the advice which the provider is requested by the client to give.²

Comments on Treasury's proposal

Our principle concern with Treasury's proposed wording is that it is neither a replacement for a defence or a definition of the duty (s961C(1)).

Whilst the proposed wording could provide some guidance to a court that the duty is about conduct (i.e. "must act"), our concern remains that we are still left with a broadly undefined duty which provides no clarity as to what it is intended to mean.

We recognise that the proposed wording suggests that there could be a range of ways of acting that could reasonably be regarded as being in the client's best interest and the adviser only has to have a reasonable basis for believing that their conduct is in the client's best interest.

Irrespective, we submit that the FSC defence is to be preferred on the basis that it includes a reference to the circumstances of the advice and to the client's instructions. If a defence along these lines is not acceptable, at a minimum we request Treasury amend the proposed wording to read:

"When giving the advice, the provider must act in the a way that could reasonably be regarded as in the best interests of the client having regard to the circumstances at the time the advice was given including the instructions provided by the client"

The FSC submits that the above line, along with additional guidance in the heading, note(s) or EM as to what it is intended to address, whilst not our preference, is preferable over what has

² This subsection is a prosed subsection to address the industries concern regarding the ability to agree on the subject matter of the advice (and not to limit the duty).

been previously been circulated in the Exposure Draft and as proposed by Treasury as noted on page 1 of this paper.

We note that we also remain concerned that the subsection (2) requirements as proposed originally in the Exposure Draft focus on outcomes rather than the reasonableness of the process followed having regard to the process followed and the considerations the adviser takes into account.

We submit that Treasury's proposed wording be inserted to s961C(2) to address this concern and at a minimum extra guidance be provided in the EM if no further changes are proposed for this section. However, we note that Treasury indicated some amendments to this effect in discussion on 3 November which would be welcome by the industry.

We are happy to discuss these comments with Treasury.