10 OCTOBER 2013

FUTURE OF FINANCIAL ADVICE SERIES

BEST INTERESTS DUTY

WHAT IS IT?

The best interests duty requires financial advisers to place the interests of their clients ahead of their own in providing personal advice to retail clients. It is designed to build trust and confidence in the financial advice industry through an enhanced standard which aligns the interests of the adviser with their client, thereby reducing conflicts of interest.

COMPLIANCE - WHAT TO LOOK FOR

The term "best interests" is not defined in the new legislation. However, an adviser will comply with the best interests duty if they comply with the "safe harbour" provisions set out in the Act, which requires:

1. Identifying their client's relevant circumstances (objectives, financial situation and needs);
2. Identifying the subject matter of the advice that is sought by their client (and the relevant personal circumstances that are relevant to the advice sought);
3. Making reasonable inquiries to obtain complete and accurate information from their client in relation to their relevant circumstances where information is incomplete or inaccurate;
4. Assessing whether the financial adviser has the expertise required to provide the client advice on the subject matter sought (and, if not, decline to provide the advice);
5. Considering recommending a financial product (if reasonable). This includes:
   - conducting a reasonable investigation into relevant financial products; and
   - assessing the information gathered in the investigation.
6. Basing all judgments in advising the client on the client's relevant circumstances; and
7. Taking any other step that, at the time the advice is provided, would reasonably be regarded as being in the best interests of their client, given the client's relevant circumstances.

The last two steps are perhaps the most significant, as previously financial advisers could provide advice which satisfied their statutory obligations but may not necessarily have been in their client's best interest.

Australian Financial Services (AFS) licensees commonly require their advisers (including authorised representatives) to provide advice only in relation to products on the Approved Product Lists (APL). The products which appear on APL may be more profitable to the licensee and the adviser than alternative products. The adviser may sometimes act as a "product pipeline" to their clients.

The best interests duty requires a financial adviser to conduct a reasonable investigation into relevant financial products (including those not necessarily included on their licensee's APL and base their advice on the client's relevant circumstances rather than the benefit that the adviser or the licensee will receive from the recommendation to invest in an "approved" product.

The requirement for financial advisers to investigate or consider products that are not included on the APL may be problematic under the current Policy Wordings for financial advisers. The bulk of the Policy Wordings in the industry exclude cover for any claims arising from an adviser recommending an investment outside their licensee's APL. Underwriters may wish to review this type of exclusion in circumstances where it can be established that the adviser made the recommendation to comply with the best interests duty.

The best interests duty does not require that the advice is "perfect." The Australian Securities and Investments Commission (ASIC) has indicated that in assessing whether a financial adviser has complied with the best interests duty, they will consider whether a *reasonable* financial adviser would *believe* that the client is *likely* to be in a better position, if the client follows the advice. ASIC has confirmed that it will not examine investment performance retrospectively and its focus will be upon how an adviser has acted in providing the advice rather than the outcome of that action.

Financial advisers must ensure they can *demonstrate* that they have taken the necessary steps to comply with the best interests duty. This is particularly the case where:

- A client elects to bring a formal complaint against the adviser at an external dispute resolution scheme such as the Financial Ombudsman Service or the Credit Ombudsman Service; and
- Either of those schemes are required to determine the complaint primarily on the contemporaneous documents which are held on the adviser's file.

The best interests duty and related obligations generally apply to the individual providing the advice. A failure to comply with the best interests duty may result in:

- a formal complaint being made to an external dispute resolution scheme (such as the Financial Ombudsman Service or Credit Ombudsman Service) against the adviser's licensee;
- a claim for compensation being brought against the adviser and/ or their licensee;
- a civil penalty being issued against the adviser and/ or their licensee; or
- an administrative sanction being made such as a ban from providing financial services for a period of time.

The best interests duty is a significant change to the existing state of the law and has a wide ranging impact upon financial advisers who operate across different industry sectors including financial planning, stockbroking, superannuation, accounting and banking. It requires that financial advisers place the interests of their clients ahead of their own. Insured parties should endeavour to comply with the steps set out above to ensure that they comply with the best interests duty.

The best interests duty does not require advisers to provide "perfect" advice but an adviser must ensure that a reasonable provider would believe that the client is likely to be in a better position if they follow their advice.

The Future of Financial Advice (FOFA) reforms contain a number of exemptions and limitations that reduce the impact of the reforms in relation to those advising about general insurance. For insurance brokers who are providing advice solely in relation to general insurance, only the first three elements of the best interests duty will apply.

CHECKLIST FOR INSURERS

We recommend claims officers consider the checklist below when reviewing any claim brought against a financial adviser post FOFA. We also recommend that insurers review current claim form and proposal form templates and consider updating them to include reference to some of the matters set out below.

- ✓ Has the adviser kept adequate records of the advice provided? Record keeping will be particularly important in relation to any post-FOFA claim or complaint made against the adviser or their licensee. We recommend that advisers be encouraged to improve record-keeping and to maintain diligent notes of advice and interactions with their clients, in order to be able to defend any claim that may be brought against them. In this regard, consider:
  - Whether the records contain evidence of the basis on which a reasonable advice provider in their position would believe that the advice is likely to leave the client in a better position if the client followed the advice; and
  - Whether the adviser has more detailed records in cases where there is an ostensible conflict between the client's interest and their own or that of a related party (such as a record which sets out the reasoning behind any recommendation that a client acquire new financial products).
- ✓ Has the adviser identified the objectives, financial situation and needs of the client that were disclosed by the client through his or her instructions?
- ✓ Has the adviser identified the subject matter of the advice sought by the client? This should, in our view, be included in writing to the client.
- ✓ Has the adviser identified the objectives, financial situation and needs of the client that would reasonably be considered relevant to the advice sought on that subject matter (i.e. the client's relevant circumstances)?
- ✓ If it is reasonably apparent that information relating to the client's relevant circumstances is incomplete or inaccurate, has the adviser made reasonable inquiries to obtain complete and accurate information? In the event it is reasonably apparent that the advice is based on incomplete or inaccurate information about the client's relevant circumstances, has the adviser provided a warning to the client that this is the case? This warning should be documented in writing to the adviser's client.
- ✓ Has the adviser assessed whether he or she has the expertise required to provide the client with advice on the subject matter sought and, if not, declined to provide the advice? Any decision to decline to provide the advice should be documented by the adviser in writing to the client.
- ✓ If the adviser considers it reasonable to recommend a financial product, has the adviser:
  - Conducted a reasonable investigation into the financial products that might achieve the objectives and meet the needs of the client that would reasonably be considered relevant to advice on that subject matter; and
  - Assessed the information gathered in the investigation?

  In this regard, has the adviser:

  - Used research reports produced by external providers to identify products that may be suitable for clients;
  - Benchmarked, at appropriate intervals, the product against the market for similar products to establish its competitiveness on key criteria such as performance history over an appropriate period, features, fees and risk; and
  - Investigated or considered a product that is not on the licensee's "Approved Product List"?
- ✓ Has the adviser based all judgments in advising the client on the client's relevant circumstances?
- ✓ Has the adviser taken all possible steps that would reasonably be regarded as being in

the best interests of the client, given the client's relevant circumstances?

- ✓ Is it reasonable for the adviser to conclude that the advice is appropriate for the client?
- ✓ Has the adviser prioritised the interests of the client over his or her own interests and those of any related party including the adviser's licensee and any associates of the licensee?
- ✓ Has the adviser taken all necessary steps to ensure that the client improves their understanding of their financial position? This should be included where possible in writing to the client by the use of cash flow projections and the like.
- ✓ Has the adviser taken all necessary steps to align the client's financial position with their appetite for risk? This should be included where possible in writing by ensuring that the client's risk profile has been properly determined and identified to the client in writing.

LOOK OUT FOR

Look out for our next FOFA update "Ban on conflicted remuneration."

MORE INFORMATION

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