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FEDERAL COURT PROVIDES HELPFUL GUIDANCE ON A RANGE OF AFSL CONCEPTS

14 February 2020 | Australia
Legal Briefings – By **Steven Rice and Fiona Smedley**

On 5 February 2020, the Federal Court of Australia handed down its decision in *Australian Securities and Investments Commission v One Tech Media Ltd* [2020] FCA 46 (***One Tech Media***). The Court found that One Tech Media Limited (**One Tech**), Allianz Metro Pty Ltd (**Allianz Australia**) and others had breached the *Corporations Act 2001* (Cth) (**Corporations Act**) in relation to the sale of binary options to retail clients.

The case is particularly relevant to the financial services industry in that it considers:

- the meaning of "arranging" as it relates to issuing financial products;
- custodial or depository services with respect to the receipt of monies for investment;
- the standard of behaviour required to make a finding of unconscionable conduct; and
- the meaning of "inducing" as it applies to the provision of financial services to clients in Australia.

BACKGROUND

In this case, One Tech and others were found to have breached the Corporations Act and the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**) by:

- carrying on a financial services business in Australia without an Australian financial services licence (**AFSL**) by offering trading in binary options through certain websites;
- carrying on a financial services business in Australia without an AFSL by "arranging" for the issue of the binary options;
- issuing financial products without issuing requisite product disclosure statements;
- engaging in conduct that was misleading or deceptive and dishonest, and making false and misleading statements, in relation to financial services;
- engaging in unconscionable conduct; and
- providing a custodial or depository service in Australia without an AFSL.

"ARRANGING" FOR ANOTHER PERSON TO DEAL

Section 766C(1) of the Corporations Act provides that a person "deals" in a financial product by amongst other things, issuing a financial product. Section 766C(2) further provides that a person also deals by "arranging for" a person to engage in such conduct.

The term "arranging" is not defined in the Corporations Act. In Regulatory Guide *RG 36 Licensing: Financial product advice and dealing* at RG 36.42 ASIC states that "arranging" is a broad concept under the Corporations Act and its scope has not been fully determined by the courts.

In the absence of a definition in the Corporations Act, Davies J noted in One Tech Media at [132] that:

> *"The verb "to arrange" has a broad meaning which includes "to make preparations" (Macquarie Dictionary, 7th edition, p 76) and there is no warrant for giving the term "arranging for" in the context of s 766C(2) of the Corporations Act a narrow or restricted meaning."*

As evidence of the limited case law surrounding the meaning of "arranging", Davies J was presented with one Australian case, as well as English and Canadian authority on the meaning of the expression in financial regulatory legislation.

Referring to the decision in the Australian case of *Australian Securities and Investments Commission v Stone Assets Management Pty Ltd* [2012] FCA 630; 205 FCR 120, Davies J noted at [126]:

> *"the facilitation of the company's client's access to the platform, which in turn allowed the client to acquire the contracts for difference was sufficient to bring the activity within s 766C(2)"*.

In the English case of *Re The Inertia Partnership LLP* [2007] EQHC 539 (Ch), it was noted that the word "arrangements" was capable of having a very broad meaning which stood in "contradistinction" from the word "transaction", and that a person could make arrangements without that person's activities involving the facilitation or execution of every step necessary for entering into the transaction.

On the facts of the case before her Honour, Davies J held that the paying agency services which were provided by Allianz Australia, including the provision of bank accounts to receive deposit funds, the vetting of customer information, and the facilitation and dealing with the receipt and remittance of customer funds, were integral to the binary options trading by customers and constituted "arranging" for the issuing of binary options.

This aspect of the decision highlights the broad meaning given to "arranging" by ASIC and the courts. Service providers to both product issuers and other dealers should carefully consider whether their services cross over into dealing and therefore AFSL territory, even though the essence of the service might feel administrative or 'back office' in nature. Similarly, promoters of financial products will need to consider whether their services go beyond financial product advice and into dealing by arranging to issue.

CUSTODIAL AND DEPOSITARY SERVICES

Section 766E(1) of the Corporations Act relevantly defines a custodial or depository service as one in which a person under an arrangement with a client, or with another person with whom the client has an arrangement, holds a financial product, or a beneficial interest in a financial product, on trust for, or on behalf of the client or the client's nominee.

ASIC contended that Allianz Australia was the "provider" of a custodial or depository service, within the meaning of section 766E(1), because:

- it had an arrangement with the "client", being the website customers (by way of a letter of indemnity); and
- it had an arrangement with "another person with whom the client had an arrangement", being One Tech (as per the paying agency agreement between One Tech and Allianz Australia); and
- on account of there being more than 20 website customers (which made it ineligible for a regulatory exemption, which may have otherwise applied).

Turning to whether a financial product was held in the arrangement, Davies J firstly addressed the claim that the deposited funds received from the investors and deposited into special "Allianz Business One Accounts" were "financial products" as defined under section 763A(1), in that the funds were used to make the investments in the binary options. In this case, Davies J disagreed with the findings of Flanagan J in *Australian Securities and Investments Commission v Munro* [2016] QSC 9 (***Munro***) and also Bromwich J in *Wang v Australian Securities and Investments Commission* [2019] FCA 1178 (***Wang***), stating at [145]:

> *"…their Honours incorrectly conflated the use of the funds to make a financial investment with the financial product by which the financial return is generated"*.

Davies J agreed with the submission of Allianz Australia, that money itself is not "a facility through which, or through the acquisition of which, a person…makes a financial investment". Her Honour did however accept, albeit in obiter, Flanagan J's finding in the decision of *Australian Securities and Investments Commission v Goldsky Global Access Fund Pty Ltd & Ors* [2019] QSC 114 (***Goldsky Global***), that bank accounts, could be a "facility" through which the investors make their "financial investments", within the broad meaning of section 762C of the Corporations Act.

Notwithstanding the finding in Goldsky Global and on the facts of the case, Davies J found that Allianz Australia had not provided a custodial or depository service. Through the contractual arrangements that Allianz Australia had in place, Allianz Australia did not use the funds itself to generate a financial return for the investors, nor did it intend for the deposited returns to be used to generate a financial return for the investor, and so the requirements in sections 763A(1) and 763B of the Corporations Act had not been met. Additionally, Davies J found that Allianz Australia did not have any "arrangement" in place by which the binary options, or a beneficial interest in the binary options was held by Allianz Australia in trust for, or on behalf of, the investors: at [147].

This aspect of the decision highlights a number of important matters:

- ASIC often seeks to rely on the general financial product concept of a facility for making a financial investment (s 763A(1)(a)) for the purposes of regulatory enforcement;
- although a bank account falls within the definition of a "facility", the funds themselves in the bank account will not typically be such a facility; and
- the Court did not appear to consider the exemption in Corporations Regulation 7.1.40(1)(a) to the effect that holding a basic deposit product is not the provision of a custodial or depository service.

UNCONSCIONABLE CONDUCT

The test for "unconscionable conduct" within the meaning of section 12CB of the ASIC Act, was recently considered in the High Court case of *Australian Securities and Investments Commission v Kobelt* [2019] HCA 18; 93 ALR 743 (***Kobelt***). In that case Gageler J, referring to section 12CB, stated at [92]:

> *"conduct proscribed by the section as unconscionable is conduct that is so far outside societal norms of acceptable commercial behaviour as to warrant condemnation as conduct that is offensive to conscience."*

Notwithstanding this high bar, Davies J concluded that One Tech had engaged in unconscionable conduct in connection with the supply of financial services.

In reaching her decision, Davies J pointed to the relevant facts before her such as the investors being in a much weaker bargaining position, they did not understand the documents they were provided with, and unfair tactics were used to entice investors to place trades and to deposit substantial amounts of money.

Following Gageler J, in Kobelt, Davies J concluded at [86]:

> *"One Tech acted outside of societal norms of acceptable commercial behaviour by placing pressure on investors who were elderly, living with disability or ill health, retired and living off superannuation funds, to take funds on which they lived and use those funds in risky trades in binary options which they were bound to lose."*

Having determined that One Tech had contravened section 12CB(1) of the ASIC Act, Davies J was not required to consider section 12CA of the ASIC Act, which relates to engaging in unconscionable conduct within the meaning of the unwritten law. However, in obiter, Davies J noted that she would have found that the conduct in relation to each of the investors who gave evidence was also a contravention of section 12CA, stating that the conduct "constituted the knowing exploitation of a special disadvantage", as considered in the case of *Commercial Bank of Australia v Amadio* [1983] HCA 14; 151 CLR 447.

INDUCING

Section 911D of the Corporations Act provides that a financial services business is taken to be carried on in Australia, if the conduct engaged in, is amongst other things, intended to induce people in Australia to use those financial services. The intention of this section is to make clear that if a foreign financial service provider seeks to induce people in Australia to avail of its financial services, that foreign entity is required to hold an appropriate AFSL or rely on an exemption.

Davies J found that One Tech had induced people in Australia to use the financial services it was providing on the basis that:

- its websites, which facilitated the trading in binary options, were accessible in Australia;
- these websites were designed to induce people to trade in binary options; and
- as a result customers in Australia did trade in binary options using the websites.

One Tech Media illustrates the ease with which the jurisdictional nexus required to meet the test in section 911D can be met and serves as a timely reminder to foreign financial service providers, who generally make their financial services available on a website.

Offshore financial service providers who currently use the limited connection (Class Order [CO 03/824]) AFSL exemption to manage being deemed to carry on a business in Australia under section 911D should remember that that exemption is due to expire on 31 March 2020 with a short transitional period. See our article from 3 July 2019 for more information.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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