

TO INFINITY AND BEYOND: THE FAIRNESS DOCTRINE

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Legal Briefings - By **Michael Vrisakis, Tamanna Islam and Guy Spielman**

The implications of the recent Full Federal Court decision in *ASIC v Westpac Securities Administration Limited* [2019] FCAFC 187 (**ASIC v Westpac**) are far-reaching for the financial services industry. The case is, of course, a significant development in the laws concerning the parameters of general advice and personal advice. However, the potential impact on the provision and regulation of financial services more broadly should be explored.

At its core, the judgment is a practical application of the "six norms of conduct" set out by Commissioner Hayne in the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. In particular, the principles of fairness and the provision of services that are "fit for purpose" are reflected in the Full Court's findings on personal advice and the obligation to act efficiently, honestly and fairly.

RIPPLE EFFECT ON FINANCIAL SERVICES

This concept of fairness is transforming the nature of compliance in financial services, with the potential to have a ripple effect on product design, distribution and disclosure. Of particular note is the statement by Allsop CJ in the judgment at [173] that:

"The [efficiently, honestly and fairly] provision is part of the statute's legislative policy to require social and commercial norms or standards of behaviour to be adhered to."

This observation demonstrates how the existing apparatus of financial services law in the *Corporations Act 2001* (Cth) (**Corporations Act**) can, and is likely to, evolve in line with “community expectations”.

In this way, the fairness doctrine could give rise to a two-pronged test in the provision of financial services:

- is the conduct compliant with the specific legal obligations set out in legislation and the general law; and
- is the conduct consistent with the standard of fairness in the circumstances?

The inter-relationship of these prongs is illustrated in the *ASIC v Westpac* decision. We now turn to the particulars of that decision.

ASIC V WESTPAC APPEAL

ASIC v Westpac is an appeal by ASIC to the Full Federal Court against Gleeson J’s finding at first instance in the Federal Court that personal advice was not given by representatives of Westpac Securities Administration Limited (**Westpac**).

During a Westpac marketing campaign, current members of superannuation funds of Westpac’s related party, BT Funds Management Limited (**BT**), were encouraged to rollover their other superannuation accounts into their existing BT account by accepting a free consolidation service provided by Westpac.

Gleeson J held that in the circumstances, Westpac’s conduct did not amount to the provision of personal advice under section 766B(3) of the *Corporations Act* and was general advice only. However, Gleeson J held that in giving general advice, Westpac failed to do all things necessary to ensure that it provided financial services efficiently, honestly and fairly as required under section 912A(1)(a) of the *Corporations Act*.

The appeal involved:

- an appeal by ASIC against Gleeson J’s decision on the provision of personal advice; and
- a cross-appeal by Westpac against Gleeson J’s decision on the obligation to provide financial services efficiently, honestly and fairly.

In a unanimous decision (set out in three separate judgments), Allsop CJ and Jagot and O'Bryan JJ:

- upheld ASIC's appeal and determined that Westpac did provide personal advice in its campaign; and
- dismissed Westpac's cross-appeal on the obligation to provide financial services efficiently, honestly and fairly.

In doing so, the Full Court provided clarity on the parameters of general advice and personal advice, and the expectations around efficient, honest and fair conduct.

PERSONAL ADVICE AT A MACRO LEVEL - THE GOALPOSTS

Under section 766B(3) of the Corporations Act, personal advice is financial product advice that is given or directed to a person in circumstances where:

- the provider of the advice has considered one or more of the person's objectives, financial situation and needs (**First Limb**); or
- a reasonable person might expect the provider to have considered one or more of those matters (**Second Limb**).

The Full Court found that Westpac provided personal advice within the meaning of the Second Limb. In coming to this finding, Allsop CJ commented at [145] that:

"This conclusion is neither forced nor technical. It reflects the substance of the human exchange."

The following factors were noted:

- each telephone call contained an implied recommendation that the customer should accept the service to consolidate their superannuation into their BT account, which

carried with it an implied statement of opinion that this step would meet and fulfil the concerns and objectives of the customer (at [77]). Such objectives were enunciated on the call in answer to deliberate questions by the callers about paying too much in fees and enhancing manageability;

- each call involved the representative getting the customer to make their decision on consolidation during the call (the “closing” aspect). O’Byran J observed that there is a material difference between influencing a person in respect of a decision and urging the person to make a particular decision (at [345]). Where advice is merely a statement of opinion that is not also a recommendation, a reasonable person is less likely to expect the provider of the advice to have considered one or more of the person’s personal circumstances. However, if the advice conveys a recommendation, that expectation is more likely to arise (at [392]);
- the customers might have expected that the advice was in their interests and with regard to their personal circumstances, given there was a pre-existing relationship between Westpac and the customer. Further, the call was positioned as a call to help the customer, rather than as a sales call (at [55]); and
- the customers may have further expected that the caller would have regard to their personal circumstances given the importance of superannuation as a subject. All three judges stated that it was material that the consolidation of a customer’s superannuation accounts is a significant financial decision.

Further, while the general advice warning prescribed under section 949A of the Corporations Act had been given by Westpac, Jagot and O’Byran JJ discounted the effectiveness of the warning in this case because:

- it was given at the beginning of the call, before the customer was asked about their objectives, financial situation and needs;
- the caller undermined the message conveyed by the warning during the call (by positioning the call as a call to assist the customer through consolidation, and by appearing to consider personal circumstances such as the customer’s objectives of saving fees and having better manageability of superannuation by consolidating accounts); and
- the general advice warning was not reemphasised during the call.

Based on the above, the Court held that while it was not necessarily the case that the callers had taken the customer's personal circumstances into account (ie the First Limb), a reasonable customer might have expected that the caller had done so under the Second Limb.

What these judicial observations mean in practice is that the goalposts for the application of the Second Limb of personal advice have shifted. Factors such as knowledge of the customer, the significance of the financial subject matter being discussed and taking the engagement with the customer through to a point of decision can increase the risk of the Second Limb being enlivened. This narrows the sphere of operation for general advice.

PERSONAL ADVICE AT A MICRO LEVEL - THE ELEMENTS

WHAT IS A "RECOMMENDATION OR A STATEMENT OF OPINION" IN SECTION 766B(1)?

Section 766B(1) of the Corporations Act provides that "financial product advice" means a recommendation or a statement of opinion, or a report of either of those things, that is either intended to influence a person in making a decision in relation to a financial product or could reasonably be regarded as being intended to have such an influence.

On appeal, Westpac contended that the words "recommendation" and "statement of opinion" in section 766B(1) required an advice aspect, and that something can only be a "recommendation" or "statement of opinion" for the purposes of the section if the recommendation or statement of opinion has the character of advice.

The Full Court rejected this submission. O'Bryan J stated at [336]:

"The word "recommendation" means to commend or urge a particular course of action. The word "opinion" means the expression of a belief, view, estimation or judgment."

Allsop CJ and Jagot J accepted that something could be "mere marketing" or advertising material, or "mere puffery", and would not amount to a recommendation or statement of opinion under section 766B(1). However, their Honours considered the distinction sought to be drawn by Westpac between "marketing" and "advice" was not appropriate for the purposes of determining whether a communication amounted to financial product advice. A communication could be both financial product advice and have a marketing or sales purpose.

WHAT CONSTITUTES "CONSIDERED" IN SECTION 766B(3)?

As mentioned above, section 766B(3) provides that "personal advice" is financial product advice that is given or directed to a person in circumstances where either:

- the provider of the advice has considered one or more of the person’s objectives, financial situation and needs; or
- a reasonable person might expect the provider to have considered one or more of those matters.

The Full Court held that the ordinary meaning of “considered” in the context of section 766B(3) was to take into account, pay attention to or have regard to (at [26]). This is a lower threshold than the test applied by Gleeson J at first instance, where Her Honour held that “considered” required “an active intellectual process of evaluating or reflecting upon the subject matter of the advice”, in line with the meaning of the term in an administrative law context.

HOW IS “ONE OR MORE OF THE PERSON’S OBJECTIVES, FINANCIAL SITUATION AND NEEDS” IN SECTION 766B(3) TO BE READ?

The Full Court held that personal advice may be provided if the provider considers the person’s objectives, financial situation or needs and that there was no requirement to consider all three matters. Specifically:

- Allsop CJ found that the phrase requires sufficient aspects of the objectives, the financial situation or needs of the person to be considered (at [29]);
- Jagot J agreed with Gleeson J’s construction, that the phrase refers to “one or more of a person’s objectives; one or more aspects of the person’s financial situation or one or more of the person’s needs” (at [253]); and
- O’Byrne J agreed with the effect of Gleeson J’s construction – the requirement is that the provider has considered to some extent one or more of the advice recipient’s objectives, financial situation or needs (at [371]).

Allsop CJ observed that when a conversation only concerns a single issue, as was the case here in respect of the consolidation of multiple superannuation accounts, the objectives for the purposes of section 766B(3) are those relevant to that issue, which were in this case the saving on fees and better manageability of superannuation (at [71]).

WHO IS THE “REASONABLE PERSON” IN SECTION 766B(3)(B)?

Gleeson J at first instance had interpreted the “reasonable person” to be a reasonable bystander imbued with knowledge of all relevant circumstances, and not just the knowledge that would have been known to a person in the shoes of the recipient of the advice.

This construction was overturned on appeal. The Full Court held that the “reasonable person” in section 766B(3)(b) is a reasonable person in the position of the recipient of the advice who would not have knowledge of circumstances or matters extraneous to their interaction with the adviser.

Jagot J also observed that section 766B(3)(b) refers to what the reasonable person might expect, which is a lower standard than what the reasonable person would have expected. The standard is one of reasonable possibility, not reasonable probability (at [267]).

WHAT DOES “IN CIRCUMSTANCES WHERE” IN SECTION 766B(3)(B) MEAN?

The Full Court held that the circumstances necessarily include the totality of the interactions with the customer and the context, and that it is not helpful to draw fine distinctions between “opinion”, “fact”, “statement of opinion” and “statement of fact” (at [19]). The pre-existing relationship between Westpac and the customer, and the overall tone of the call being one of assistance, were integral to the finding of personal advice.

Allsop CJ stated at [20]:

“The task is to look at the communication or exchange, in its whole context, and assess whether some express or implied recommendation or statement of opinion is made. This is unlikely to be assisted by minute examination of parts of the text of a flowing, whole, engaged human conversation with all its implicit, as well as explicit, content. One can well understand that in some contexts mere statements of fact will not qualify as recommendations or statements of opinion. That is not, however, a conclusion that is to be drawn by an abstracted distinction between statements of fact and inference or by the deconstruction of text, but rather by looking at, or listening to, the whole of the communication or exchange, in its context.”

BEST INTERESTS DUTY REAFFIRMED AS INPUTS BASED

The Full Court reconfirmed the existing legal understanding of the best interests duty in section 961B of the Corporations Act. The best interests duty is not about whether the substance of advice is in best interests of the customer. Rather, it is concerned with action and objective purpose. O’Byrne J noted at [405]:

“In my view, textual and contextual considerations compel a conclusion that s 961B is not concerned with the question whether the substance of the advice is in the best interests of the client and, if it was necessary to refer to it, the relevant extrinsic materials confirm that conclusion. Rather, the section is concerned with the actions taken by the provider in the formulation of the advice and the objective purpose of the provider in taking those actions and giving the advice.”

This is an important recognition that the best interest duty does not require an adviser to achieve the best possible financial outcome for the customer, but is more concerned with due consideration of the client’s interests.

EFFICIENTLY, HONESTLY AND FAIRLY

Section 912A(1)(a) of the Corporations Act requires a financial services licensee to do all things necessary to ensure that the financial services covered by its licence are provided efficiently, honestly and fairly.

In effect, the Full Court upheld the decision of Gleeson J at first instance that a general advice model for the consolidation of superannuation was not fit for purpose, as the decision to consolidate superannuation funds into one chosen fund is not a decision suitable for general advice that promotes a particular fund. Rather, the decision requires attention to the personal circumstances of a customer and the features of the multiple funds held by the customer.

The Full Court reserved its full consideration of the duty to act efficiently, honestly and fairly for an occasion in which the matter was in issue. However, O'Bryan J stated in obiter at [426] that:

“It seems to me that the concepts of efficiently, honestly and fairly are not inherently in conflict with each other and that the ordinary meaning of the words used in s 912A(1)(a) is to impose three concurrent obligations on the financial services licensee: to ensure that the financial services are provided efficiently, and are provided honestly, and are provided fairly.”

Similarly, Allsop CJ at [170] stated that:

“...if a body of deliberate and carefully planned conduct can be characterised as unfair, even if it cannot be described as dishonest, such may suffice for the proper characterisation to be made.”

Such an approach is somewhat of a departure from previous authority on the duty. In particular, Young J in *Story v National Companies And Securities Commission* (1988) 13 NSWLR 661 at [672] held that:

“the group of words “efficiently, honestly and fairly” must be read as a compendious indication meaning a person who goes about their duties efficiently having regard to the dictates of honesty and fairness, honestly having regard to the dictates of efficiency and fairness, and fairly having regard to the dictates of efficiency and honesty.”

These developments all point to a growing sense of the primacy and self-standing nature of the fairness obligation.

It is also important to bear in mind that these developments occur against the backdrop of existing obligations at common law and in equity which, in certain circumstances, may require an advice provider to take the personal circumstances of a customer into account. Section 960B of the Corporations Act states that the obligations imposed by Part 7.7A of the Corporations Act are in addition to any other obligations applicable under law. In this regard, an advice provider may have a duty of care, skill and diligence and a duty of good faith that require the provider to consider a customer's personal circumstances in particular contexts, such as where the customer engagement involves discussion of important financial subject matter.

ONGOING VIABILITY OF GENERAL ADVICE

The ASIC v Westpac decision shows the relative ease with which a provider may transgress into personal advice territory. Relevant factors will include the subject matter of the conversation, the existing relationship with the customer and the encouragement to act (ie an implied recommendation).

General advice continues to be a viable model for financial services licensees. However, the narrowing of the goalposts by ASIC v Westpac has increased the risk profile of general advice models.

The Full Court leaves open the possibility of general advice if the recommendation is framed generally. Allsop CJ states at [79] that:

“One view of looking at the matter favourably to Westpac is that the whole circumstances should be characterised as if, after being told by the customer that she was concerned with fees eating away at her accounts and with having greater manageability, the caller said: “That is what many of our customers say. As a general proposition, consolidation can potentially save on fees and will generally enhance manageability. For those general reasons I recommend accepting our service”. If that is the correct characterisation of the exchange, it might be seen as a decision brought about by general advice without telling her that there are other important considerations that may bear on her prudent decision. On this view of the matter, the failure to say other things by way of caution (whilst perhaps being otherwise subject of criticism) would not transform the advice, being hitherto general in character, into personal advice.”

It follows that general advice is workable where:

- the features of a product are not canvassed as addressing or fulfilling the needs or objectives of the particular customer;
- the content of the conversation is strictly limited in cases where there is a pre-existing customer relationship;

- a reasonable customer would have understood that they were only getting general advice, such as through re-emphasis of the general advice warning with a view to ensuring that such warning is not too remote; and
- the subject matter is appropriate for general advice.

The more interaction between the advice provider and the customer and the greater the personal focus on the customer, the higher the risk that the engagement will trespass into personal advice. Ultimately, this will be a question of degree.

General advice will also continue to be a mechanism for distribution through digital channels (such as websites and generic calculators).

THE FAIRNESS DOCTRINE - BEYOND FINANCIAL ADVICE

The Full Federal Court in ASIC v Westpac, through the obligation to act efficiently, honestly and fairly, effectively found that it was unfair to sell a financial product on a general advice model, where a customer decision could only prudently be made with knowledge and consideration of the customer's personal circumstances.

This finding has the potential to impact the provision of financial services beyond the provision of financial advice.

In recent years, ASIC has added what it considers to be low value products to its enforcement priorities. This can be seen in its focus on add-on insurance products and consumer credit insurance. The Royal Commission similarly shone a spotlight onto the concept of "value" for customers, with the Final Report containing the following characterisations and observations:

- the characterisation of trail commission as "money for nothing";
- add-on and funeral insurance being of low value to customers;
- often, there is provision of services where the benefits are not commensurate with the costs of such services, such as advice services under ongoing fee arrangements; and
- there is asymmetry of information and understanding on the value of complex financial products between customers and product issuers.

Commissioner Hayne also noted that certain insurance products yield high profits for the issuer, almost always because the claims ratio for the product is low.

This focus on value is given further regulatory teeth with the introduction of ASIC's product intervention powers, which allow ASIC to intervene and take action where it considers financial and credit products have resulted in, or are likely to result in, significant consumer detriment. The application of this power has already been contemplated in the add-on insurance and short term credit product spaces.

Similarly, the Australian Financial Complaints Authority (**AFCA**) adopts a fairness standard within its jurisdiction.

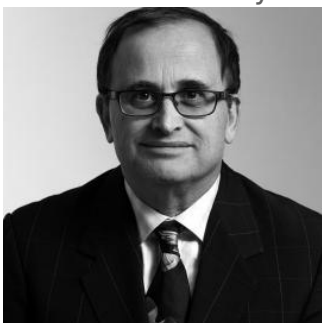
This trend towards a fairness standard can also be seen in recent reform proposals in New Zealand, with the Government of New Zealand proposing the introduction of a new regime to govern conduct in the financial sector. A key aspect of the proposed reform is a new obligation to meet a fair treatment standard and treat customers fairly, driven by a Government priority to better regulate conduct and culture in the New Zealand financial sector.

In Australia, the ASIC v Westpac decision imposes an additional overlay, with the Courts demonstrating a willingness to enforce principles of fairness. However, this requires consideration of what the principle requires in terms of conduct and standards of behaviour from financial services licensees. Unlike the best interests duty discussed above, the fairness doctrine can be seen to be concerned not just with process, but also with customer outcomes. The "six norms of conduct" set out by Commissioner Hayne go some way in setting out community expectations in this regard.

While the practical substance of the doctrine remains to be developed, it is clear that ASIC will continue to pursue its regulatory strategy and enforcement approach of placing principles of fairness front and centre. The Full Federal Court has given it the legal backing it needed to do so.

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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