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Financial services: 'Efficiently, honestly and fairly'

By Laurence White

Australian financial services licence holders must ensure they fulfil all requirements efficiently, honestly and fairly. This obligation is subject to significant new sanctions which advisers should be aware of.

Under paragraph 912A(1)(a) of the *Corporations Act 2001* (Cth),[1] there is an obligation on Australian financial services licence (AFSL) holders (licensees) to "do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly" (the EHF obligation).

Snapshot

- Under the *Corporations Act* Australian financial services licence holders have an obligation to "do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly".
- This article discusses the obligation and consequences for breach including significant new sanctions, Australian case law, observations of the Hayne Royal Commission, ASIC guidance and the UK's treating customers fairly obligation.
- Legal advisers to financial services firms are urged to be fully aware of developments when advising their clients on individual cases and when clearing the design of new products, services and business processes.

Context of the EHF obligation and consequences of breach

The EHF obligation is part of a list of other so-called "general obligations" of licensees set out in sub-s912A(1). Notably, a licensee must:

- have in place adequate arrangements for the management of conflicts of interest (para (aa))
- subject to sub-s(4), have available adequate resources (including financial, technological and human resources) to provide the financial services covered by the licence and to carry out supervisory arrangements (para (d))
- maintain the competence to provide those financial services (para (e)) and ensure that its representatives are adequately trained (including by complying with s921D), and are competent to provide those financial services (para (f))
- have a dispute resolution system complying with sub-s(2) if those financial services are provided to persons as retail clients (para (g))
- have adequate risk management systems (subject to sub-s(5), which excepts most APRA-regulated bodies and (to some extent) RSE licensees) (para (h)).[2]

Until very recently, the main consequence of breach or apprehended breach of the EHF obligation and the other general obligations was licensing action against an existing licensee or the refusal of a new licence.[3]

Persons involved or likely to become involved in a contravention of the EHF obligation or a licensee's other general obligations, such as directors of a corporate licensee, could also be made subject to a banning order by ASIC under s920A(1)(g) or (h) or to a permanent restraining order issued by the court under s1324(1)(e).[4]

New remedies for breach

In April 2019, an additional new package of remedies for breach of the general obligations, including the EHF obligation, came into force.[5] As a result, a contravention of the EHF obligation (and of the other general obligations) constitutes a contravention of new sub-s912A(5A), which is designated a civil penalty provision by s1317E.

The maximum pecuniary penalties for breaches of the EHF obligation (and other general obligations of licensees in sub-s912A(1)) are substantial, especially when one bears in mind that there were previously no applicable pecuniary penalties:

For individuals, the greater of:

- 5000 penalty units (currently $1.05 million)[6]
- (if determinable by the court) three times the benefit derived and detriment avoided because of the contravention.

For body corporates, the greater of:

- 50,000 penalty units (currently $10.5 million)
- (if determinable by the court) three times the benefit derived and detriment avoided because of the contravention
- 10 per cent of the annual turnover of the body corporate for the 12-month period ending at the end of the month in which the body corporate contravened, or began to contravene, the civil penalty provision, capped at 2.5 million penalty units (currently $525 million).[7]

The legislation also provides for the following remedies in respect of contraventions of the EHF obligation and the other general obligations:

- declarations of contravention under s1317E, which constitute conclusive evidence of certain matters (s1317F)
- relinquishment orders under s1317GAB in respect of the benefit derived and detriment avoided by reason of the contravention.

While these new civil penalties have been applied to the EHF obligation and the other general obligations, a breach of sub-s912A(5A) does not explicitly give rise to a right to compensation for breach under the *Corporations Act*, unlike many other civil penalty provisions.[8] Any litigation to enforce a breach of these obligations would therefore need to rely on broader concepts of liability, including the potential applicability of breach of statutory duty concepts.

Australian case law

Beach J recently summarised the case law principles relating to the EHF obligation as follows:

“The ‘efficiently, honestly and fairly’ standard is applied as a single, composite concept, rather than three discrete behavioural norms. The following principles are not in doubt (see *Australian Securities and Investments Commission v Camelot Derivatives Pty Ltd (in liq)* (2012) 88 ACSR 206; [2012] FCA 414 (Camelot) at [69]and [70] per Foster J). First, the words ‘efficiently, honestly and fairly’ entail that a person must go 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. Second, the phrase connotes a requirement of competency in providing advice and in complying with relevant statutory obligations. Third, the word ‘efficient’ entails that the person is adequate in performance and is competent. Fourth, the concept of honesty is looked at through the lens of commercial morality rather than through the lens of the criminal law.[9]

Litigation over the past 20 years has seen the courts apply these principles to various fact situations.[10] Some of the more recent cases are listed below.

In *Avestra*[11] the corporate defendant used funds that it held on trust as property of its sole registered managed investment scheme to pursue a merger by way of backdoor listing. Avestra purchased shares in the target entity with members’ funds in disregard of the conflict of interest it had and without disclosing the proposed purchase to, or obtaining approval from, members of those schemes whose property Avestra had used to carry out its acquisition. It was held that Avestra had acted in contravention of the EHF obligation and also that some of its officers had been involved in that contravention.

In *CFS Private Wealth*[12] Mr Graeme Miller, the fourth respondent, misappropriated the superannuation and other savings of a group of clients to whom he purported to provide investment advice. He did that over approximately a decade through the three companies that were the other three respondents. Reeves J was satisfied that CFS Private Wealth had not provided financial services efficiently, honestly and fairly. Specifically, the company, through the actions of its sole director, Mr Miller, had not had regard to the dictates of honesty and fairness, nor conducted itself in an ethically sound way and it had not provided advice to its clients competently.

In *ASIC v Westpac Securities Administration Limited, in the matter of Westpac Securities Administration Limited* [2018] FCA 2078 the Court found contraventions of the EHF obligation where Westpac policy directed callers to encourage customers to roll over their superannuation with limited identification of customers’ personal circumstances and no consideration of customers’ best interests, explanation of risks or sufficient warning that Westpac was not considering such matters.[13]

Relevant observations of the Royal Commission

The Hayne Royal Commission’s interim and final reports referred to six norms of conduct to which financial services providers should be bound:

- obey the law
- do not mislead or deceive
- act fairly
- provide services that are fit for purpose
- deliver services with reasonable care and skill
- when acting for another, act in the best interests of that other.

In his Final Report, Commissioner Hayne said:

“The six norms of conduct I have identified are all reflected in existing law. But the reflection is piecemeal.

“The general obligations of Australian financial services licence (AFSL) holders, stated in s912A of the *Corporations Act*, and the general obligations of Australian Credit Licence (ACL) holders, stated in s47 of the NCCP Act, stand out.

“First, both provisions impose an overarching obligation to ‘do all things necessary to ensure’ that the financial services or credit activities authorised by the licence are provided ‘efficiently, honestly and fairly’ . . . Understood properly, this requirement would embrace all six norms.”[14]

Recommendation 7.4 of the final report was that “[a]s far as possible, legislation governing financial services entities should identify expressly what fundamental norms of behaviour are being pursued when particular and detailed rules are made about a particular subject matter”.[15] The federal government has undertaken to take forward this recommendation.[16] It remains to be seen how, if at all, this commitment will affect the EHF obligation, given Commissioner Hayne’s emphasis on fairness as a separate quality.

ASIC guidance

ASIC, at time of writing, has published only limited regulatory guidance on the EHF obligation itself. Regulatory Guide 104 states in part:

“If you fail to comply with the other general obligations [in s912A], it is unlikely that you will be complying with the [EHF] obligation. However, the [EHF] obligation is also a standalone obligation that operates separately from the other general obligations. For example, if you have contractual obligations to clients and breach them, this might not be a breach of the other general obligations, but it could amount to a failure to provide your financial services efficiently, honestly and fairly.”[17]

ASIC made a substantial submission to the Hayne Royal Commission which went beyond RG 104 and may illustrate its approach to the EHF obligation going forward. Some key points are:

- “There is a significant overlap between the [then] current Code of Banking Practice obligation for a bank to act ‘fairly and reasonably . . . in a consistent and ethical manner’;[18] the [EHF obligation] . . . ; and – with respect to those banks listed on the Australian Stock Exchange – Principle 3 of the ASX Corporate Governance Principles and Recommendations, that directs companies to act ‘ethically and responsibly’, in a manner that is ‘consistent with the reasonable expectations of investors and the broader community’.
- “ASIC believes that fairness is of key importance in the financial services industry. This is not limited to compliance with the law, although this is an important safeguard. Fairness requires financial services entities to conduct themselves honestly and transparently, including through prompt, effective treatment and remediation of complaints without unnecessary barriers to resolution. It requires entities to have reasonable regard to the interests of their customers. Consumers should be treated honestly and fairly at all stages of their relationship with a financial services entity.
- “As to the content of the obligation, some analogies can be found in the judicial consideration of the concept of utmost good faith in the insurance context. That duty has been described as requiring conduct consistent with ‘commercial standards of decency and fairness’. The concept has been said to encompass more than merely acting honestly, and to have elements in common with the ‘clean hands’ equitable doctrine and be something ‘akin to a fiduciary relationship’ although not a fiduciary relationship itself. It may be breached by capricious or unreasonable conduct.” [footnotes omitted][19]

In addition, the ASIC chair has addressed the EHF obligation in recent speeches in terms that foreground fairness as a separate norm, and seem to identify it with “the ethical performance of functions in accordance with professional standards”[20] and to identify a breach when a practice or product is “going to cause harm, be detrimental or have a negative consequence”.[21]

As for enforcement, ASIC and the Administrative Appeals Tribunal continue to refer to breaches or possible breaches of the EHF obligation in licensing decisions.[22] In recent times ASIC has referred to breaches of the EHF obligation in a number of high-profile actions.[23] ASIC has also suggested that failure to comply with overseas laws could constitute a breach of the EHF obligation.[24]

The UK's treating customers fairly obligation

The Australian EHF obligation finds echoes in the UK's regulatory regime for financial services.[25] A firm authorised under the UK's *Financial Services and Markets Act 2000* must comply with several "Principles for businesses" of which Principle 6 states that an authorised firm "must pay due regard to the interests of its customers and treat them fairly".[26] This obligation is often referred to as "treating customers fairly" (TCF) and the Financial Conduct Authority (FCA) identifies the following six consumer "outcomes" that firms should strive to achieve to ensure fair treatment of customers:

1. Consumers can be confident they are dealing with firms where the fair treatment of customers is central to the corporate culture.
2. Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.
3. Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.
4. Where consumers receive advice, the advice is suitable and takes account of their circumstances.
5. Consumers are provided with products that perform as firms have led them to expect, and the associated service is of an acceptable standard and as they have been led to expect.
6. Consumers do not face unreasonable postsale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.[27]

The FCA has also given guidance to the effect that targeting customers with regulated credit agreements which are unsuitable for them and subjecting them to high-pressure selling, aggressive or oppressive behaviour, or unfair coercion, contravenes this Principle.[28] The FCA has also given formal guidance on the very similar Rule 4 of its new individual code of conduct regime.[29]

The TCF obligation in the UK has been the launch-pad for very significant enforcement actions against major financial services institutions by the FCA. For example:

In December 2018, the FCA fined Santander UK Plc (Santander) £32.8 million for serious failings in its probate and bereavement process amounting to a breach of the TCF obligation. According to the FCA, Santander breached Principle 6 between 1 January 2013 and 11 July 2016 by failing to ensure that its probate and bereavement process paid due regard to the interests of its customers and those who represented them on their death.[30]

In 2015 the FCA imposed a fine of £117 million on Lloyds Banking Group for breach of the TCF obligation relating to Lloyd's failure to fairly handle customer complaints about the mis-selling of payment protection insurance.[31]

In 2013, the FCA imposed a fine of £7.4 million on Swinton Group for breach of Principle 6 (Customers' interests), finding that its business strategy of maximising sales of certain monthly add-on insurance policies was implemented at the cost of the fair treatment of its customers.[32]

Conclusions and recommendations

While the principles of Australian case law regarding the EHF obligation might appear to be settled, this is an area of law that is subject to significant tectonic pressures, including:

- the push from the Hayne Royal Commission, accepted by government, for fundamental norms to be stated more clearly, with the duty to act fairly identified separately as one of those norms
- the new sanctions regime applicable to the EHF obligation and the other general obligations of licensees, leading to dramatically higher potential monetary liabilities and concomitant reputational risks, including for directors and officers
- the influence of overseas developments, particularly the FCA's guidance on what treating customers fairly requires and its aggressive enforcement of the TCF obligation.

Legal advisers of financial services firms are urged to be fully aware of these developments when advising their clients on individual cases and when clearing the design of new products, services and business processes (including remediation, compliance and risk management programmes, systems and controls). ♦

1. Section numbers in the body of the article refer to the *Corporations Act 2001* (Cth) unless otherwise specified. The equivalent provision for credit licensees (as opposed to financial services licensees) is set out in s47 of the *National Consumer Credit Protection Act 2009 (NCCP Act)*.**Laurence White** is a barrister at the Victorian Bar. Before becoming a barrister he worked at the Australian Securities and Investments Commission, UK Financial Conduct Authority, Australian Treasury, Financial Stability Board (Basel), European Commission and Corrs Chambers Westgarth.

2. The above list is not exhaustive.

3. Sections 915C (suspension or cancellation) and s913B (refusal).

4. See *Australian Securities and Investments Commission v CFS Private Wealth Pty Ltd (No 2)* [2019] FCA 24 at [62]ff (*CFS Private Wealth*). Such persons may also be found to have contravened other relevant obligations, such as the obligation to take all steps that a reasonable person would take to ensure that a responsible entity complies with the *Corporations Act* set out in s601FD(1)(f).

5. *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019*.

6. See *Crimes Act 1914* (Cth), s4AA.

7. *Corporations Act* s1317G. See s1317GAD for the meaning of "benefit derived and detriment avoided". See s761A for the meaning of "annual turnover".

8. Compensation orders are provided for in ss1317H, 1317HA ff. for breaches of certain specified provisions. However, a breach of s912(5A) is not one of those specified (as it is an unclassified provision according to the table in s1317E(3)).

9. *Australian Securities and Investments Commission v Avestra Asset Management Limited (ACN 119 227 440) (in liq) and Others* (2017) 120 ACSR 247; [2017] FCA 497 (*Avestra*), at [191], quoted in *CFS Private Wealth* at [34] (Reeves J). As is stated in *CFS Private Wealth* at [35], the words "honestly" and "fairly", when used together, have also been said "to give the flavour of a person who not only is not dishonest, but also a person who is ethically sound": *Story v National Companies and Securities Commission* (1988) 13 NSWLR 661 at 672 (*Story*) per Young J.

10. In *Story*, a stockbroker who falsely represented in a memorandum to a prospective purchaser of a company that there was a new issue in the works and that there was "[a]nother active bidder in the wings" was found to have breached the EHF standard. In *RJ Elrington Nominees*

Pty Ltd v Corporate Affairs Commission (SA) (1989) 1 ACSR 93, the defendant was found to have breached the conditions of its licence and to have breached the equivalent of the EHF obligation by giving investment advice in relation to securities of an associated company (at 110). In *Camelot* a breach was established by the respondent inducing clients to trade in options in an endeavour to secure excessive brokerage commissions (at [71]-[74]). In *Australian Securities and Investments Commission v Cassimatis (No 8)* [2016] FCA 1023; 336 ALR 209, litigation that arose from the collapse of Storm Financial, contraventions of the *Corporations Act* relating to the provision of financial advice were considered sufficiently serious departures from reasonable standards that they also involved a breach of the EHF obligation.

11. Note 9 above.
12. Note 4 above.
13. ASIC has announced it will appeal the judgment, but not with regards to the s912A(1) issue. See ASIC media release MR 19-033 dated 18 February 2019. Available at asic.gov.au/about-asic/news-centre/find-a-media-release
14. *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry: Final Report*, Vol. 1, p. 9
15. Note 14 above, p42.
16. *Australian Government, Restoring Trust in Australia's Financial System* (February 2019), p38
17. RG 104.51-52.
18. See para 10 of the Australian Banking Association Banking Code: "We will engage with you in a fair, reasonable and ethical manner.".
19. ASIC's round 4 submissions dated 16 July 2018, at https://financialservices.royalcommission.gov.au/public-hearings/Documents/Round-4-written-submissions/ASI-written-submission.pdf. The submission also contains material of potential interest to those advising banks on enforcement options, particularly paragraphs 7-8 relating to farmer-borrowers.
20. Speech by ASIC chair James Shipton, *Conduct Regulator's Address, the AFR Banking and Wealth Summit,* (Sydney, Australia) 27 March 2019.
21. At https://asic.gov.au/about-asic/news-centre/speeches/asic-annual-forum-2019-asic-chairs-closing-remarks/.
22. For recent examples, see ASIC Media Releases 19-248MR "ASIC suspends the AFS licence of Financial Options Pty Ltd" (10 September 2019); 19-156MR "ASIC cancels the AFS licence of Guarded Pty Ltd" (26 June 2019), 19-048MR "AAT affirms ASIC's decision to refuse to grant a limited AFS licence" (5 March 2019), 19-015MR "ASIC cancels AFS licence of Jade Capital Partners and bans one director" (31 January 2019).
23. For example, see ASIC Media Releases 19-222MR "ASIC sues NAB for dealing with unlicensed home loan introducers: Royal Commission case study" (23 August 2019) (re section 47 of the *NCCP Act*); 19-191MR "ASIC sues ANZ for misrepresentations and unconscionable conduct over account fees" (25 July 2019); ASIC media release 19-180MR "ASIC finds unacceptable sales practices, poor product design and significant remediation costs in CCI sold by major banks and lenders" (11 July 2019).
24. See ASIC Media Release 19-088MR "Some AFS licensees may be breaking overseas laws" (11 April 2019).
25. For completeness, it is noted in passing that the Singaporean and Hong Kong financial services licensing regimes both contain echoes of the EHF obligation: see *Securities and Futures Ordinance 2002* (Hong Kong), s 129(1)(c) and *Securities and Futures Act 2001* (Singapore) (c. 289), s86(4)(m).
26. Financial Conduct Authority, *Handbook of Rules and Guidance*, PRIN 2.1, at www.handbook.fca.org.uk/handbook/PRIN/2/1.html.
27. FCA (2019), "Fair treatment of customers", at www.fca.org.uk/print/firms/fair-treatment-customers.
28. FCA Handbook, CONC 2.2.2, at www.handbook.fca.org.uk/handbook/CONC/2/2.html.
29. Rule 4 provides, "You must pay due regard to the interests of customers and treat them fairly." See the FCA Handbook, COCON 2.1 Individual conduct rules. Some examples of conduct that would be in breach of Rule 4, according to that guidance, are illuminating: failing to acknowledge, or seek to resolve, mistakes in dealing with customers; failing to provide terms and conditions to which a product or service is subject in a way which is clear and easy for the customer to understand: see COCON 4.1.14G.
30. FCA (2018), Final Notice to Santander UK plc dated 19 December 2018.
31. FCA (2015), Final Notice to Lloyds Bank plc, Bank of Scotland plc and Black Horse Limited (together Lloyds Banking Group "LBG"), dated 4 June 2015.
32. FCA (2013), Final Notice to Swinton Group Limited.

Note: This article was finalised prior to the Full Court of the Federal Court's judgment in *Australian Securities and Investments Commission v Westpac Securities Administration Limited* [2019] FCAFC 187 (28 October 2019). On appeal, the Court in that case found breaches of the obligation in s912A(1)(a), as well as other provisions of the Corporations Act, in circumstances not of dishonesty but of what Allsop CJ and Jagot J referred to as sharp practice in the provision of advice to superannuation customers. The case is notable for containing strong (albeit *obiter dicta*) suggestions on the part of Allsop CJ and O'Bryan J that the Court may on a suitable future occasion be minded to analyse the obligation as three separate and independent obligations rather than as a single compendious obligation. It also contains some observations by O'Bryan J relevant to the question of what a separate obligation of fairness might entail. See paragraphs [171], [173-4] (per Allsop CJ), [290] (per Jagot J), and [424], [426-7] (per O'Bryan J).

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