Keynote address

Fiduciary duties in the financial sector

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Justice Ashley Black

Introduction

I should start this presentation by recognising the continuing issues as to effective regulation of the financial services regulation; I will then note areas of overlap and complexity in the general law and statutory regulation of conflicts of interest; and then note more specific regimes which may or may not address the gaps in effective regulation; and finally address ongoing questions as to enforcement practice.

The recent history of Australian (and international) financial services regulation demonstrates both recurrent misconduct in financial services and recurrent inquiries into the effectiveness of the regime.[1] These issues have some similarity to the history of financial services regulation in the United Kingdom, which has also seen recurrent mis-selling issues.[2] Retail investors have suffered significant losses on the failure of several entities providing products and services to the retail sector and through issues as to the quality of financial advice.[3]

We all know that conduct issues in relation to financial services were also addressed in 2019 by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry ("Royal Commission").[4] The Interim Report of the Royal Commission observed that the source of many of the issues it identified was "greed" or "the pursuit of short term profit at the expense of basic standards of honesty" and the

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[1] I have drawn here on AJ Black & P Hanrahan, *Securities and Financial Services Law*, 10th ed, 2021, [11.2] and AJ Black, "Misconduct in Banking and Financial Services: Implications of Australia's recent Royal Commission", paper presented at the University of Oxford, 26 February 2020.

[2] For commentary, see J Black and R Nobles, "Personal Pensions Misselling: The Causes and Lessons of Regulatory Failure" (1998) 61 *Mod L Rev* 789; N Moloney "Regulating the Retail Market: Law, Policy and the Financial Crisis" (2010) 63 *Current Legal Problems* 375; E Ferran, "Regulatory Lessons from the Payment Protection Insurance Mis-selling Scandal in the UK" (2012) 13 *European Business Organization Law Review*, 247; N Moloney, "The investor model underlying the EU's investor protection regime: consumers or investors?" (2012) 13 *European Business Organization Law Review* 169, especially at 176ff; N Moloney, "EU Financial Market Governance and the Retail Investor: Reflections at an inflection point" (2015) 37 *Yearbook of European Law* 251, especially at 254ff; D Bugeja, *Reforming Corporate Retail Investor Protection: Regulating to Avert Mis-Selling* (Hart, 2019).

[3] For reviews of the issues, see Report of the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into Financial Products and Services in Australia (November 2009); D Kingsford Smith, "Regulating investment risk: Individuals and the global financial crisis" (2009) 22 UNSWLJ 514; ASIC Report 279, *Shadow shopping of retirement advice*, March 2012; ASIC Report 337, *SMSFs: Improving the quality of advice given to investors*, April 2013; P Hanrahan, "Regulating financial advice for retirement – the recent Australian reforms", 10 March 2017; G Pearson, "Failure in corporate governance: financial planning and greed" in C Mallin (ed), *Handbook on Corporate Governance in Financial Institutions* , 2016, pp 189-190; Senate Economics References Committee, *Agribusiness Managed Investment Schemes: Bitter Harvest*, 2016; ASIC Report 499, *Financial Advice: Fees for no service*, October 2016; ASIC Report 562, *Financial Advice: Vertically Integrated Institutions and Conflicts of Interest*, January 2018; D Wishart & A Wardrop, "What can the Banking Royal Commission achieve: Regulation for good corporate culture" (2018) 43 *Alternative LJ* 81 at 82 .

[4] I have here drawn on my paper, "Misconduct in Banking and Financial Services: Implications of Australia's recent Royal Commission", paper presented at the University of Oxford, 26 February 2020.

Royal Commission's Final Report similarly observed that:

> "in almost every case, the conduct in issue was driven not only by the relevant entity's pursuit of profit but also by individuals' pursuit of gain, whether in the form of remuneration for the individual or profit for the individual's business. Providing a service to customers was relegated to second place. Sales became all important. Those who dealt with customers became sellers. And the confusion of roles extended well beyond frontline staff. Advisers became sellers and sellers became advisers."[5]

The Royal Commission summarised its conclusions in strong terms, observing that conduct of financial services firms over "many years" had caused substantial loss to consumers and yielded substantial profit to those firms, had often broken the law and, where it had not been unlawful, had "fallen short of the kind of behaviour the community not only expects of financial services entities but is also entitled to expect of them."[6] The Royal Commission also identified many examples of conduct that was not "fair" by any standard, or did not advance the client's interests, or involved significant conflicts of interest in dealings with retail clients and observed, in language echoing the case law as to fiduciary duties, that "experience shows that conflicts between duty and interest can seldom be managed; self-interest will almost always trump duty".[7]

The Royal Commission also focussed on the commission and remuneration arrangements in respect of financial advisers, which have caused ongoing difficulties in the Australian financial services regime. The Australian statutory regime had previously sought to address the perverse incentives created by commission and volume-based fee arrangements for financial advisers[8], by Pt 7.7A Div 3 of the *Corporations Act* 2001 (Cth) ("*Corporations Act*"), introduced by the Future of Financial Advice ("FOFA") reforms, which regulated ongoing fees payable by clients. The Royal Commission highlighted difficulties with the operation of these provisions, and particularly focused on fees charged by product manufacturers and advisers which did not provide corresponding services. Part 7.7A Division 4 of the *Corporations Act* in turn regulates conflicted remuneration. These provisions were arguably undermined by a range of exceptions, and particularly by the grandfathering of existing arrangements. Happily, the grandfathering provisions have now been repealed.

The Royal Commission also identified an incomplete transition from a "sales" culture in respect of financial products towards a "profession" of providing financial advice and doubted that financial advisers had achieved the status of a "profession"[9] but did not support the possibility of distinguishing further between sales and true advisory functions in financial services. The Royal Commission also recognised the issue of conflicts of interest arising from vertical integration of product manufacturers and financial advisory firms, where, for example, product manufacturers both provide advisory services and own advisory firms that provide such services. The Royal Commission did not recommend a statutory prohibition on vertical integration of financial services businesses, but noted that more effective regulation of conflicts of interest would place pressure on those structures. Other jurisdictions have also not sought to prevent a product issuer or associated entities providing personalised

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5 Hayne Royal Commission, Final Report, pp 1-2.
6 Hayne Royal Commission, Final Report, p 1.
7 Royal Commission, Final Report, p 3.
8 For commentary, see G Pearson, "Commission Culture: A Critical Analysis of Commission Regulation in Financial Services" (2017) 36 *U Qld LJ* 155.
9 Royal Commission, Final Report, p 119.

recommendations to customers about investment products, or required financial advisers to be structurally independent of product issuers.[10] Several larger banks and intermediaries have moved away from such structures since the Royal Commission.

There have been several attempts to address these issues, including setting competency standards of advisers under the *Corporations Amendment (Professional Standards of Financial Advisers) Act* 2017 (Cth), and, possibly the most promising approach, the introduction of product design and distribution obligations by the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act* 2019 (Cth). I return to these obligations below.

These matters emphasise that, obviously enough, a sophisticated legal regime is not sufficient in itself to deliver compliance, although exceptions to and failures in a statutory regime may well be sufficient in themselves to deliver non-compliance. That is a significant issue for the overlapping general law and statutory regimes to which I now turn.

Overlapping general law and statutory regimes[11]

Turning now to the overlapping general law and statutory framework for regulation of conflicts of interest in financial services, that overlap is neither novel nor unique to the Australian regulatory regime. In a paper delivered in 2015[12], Professor MacNeil observed, in relation to the United Kingdom regulatory regime, that fiduciary duties regulated conflicts of interest more strictly than that regulatory regime and observed that:

> "Why then has so much effort been invested in devising a regulatory regime that implements a diluted form of fiduciary duty? There are probably three main reasons. One is that regulatory intervention does not take proper account of the rule of law with the result that quasi-fiduciary conduct regulation becomes characterised as a solution to market failure. Another is that regulatory rules provide a form of *ex ante* guidance with which forms can comply whereas fiduciary duty is a broad standard that can only be definitively formulated in any particular context through *ex post* adjudication. A third reason is that fiduciary duty can be adjusted or excluded by contract whereas regulatory rules (at least in the retail sector) cannot."

Professor MacNeil there identified advantages of reverting to a system in which fiduciary law played a more central role. I would not necessarily go that far, where the advantage of *ex ante* guidance is real, and the statutory regime has an important role in limiting the attraction of contractual exclusions of fiduciary duties, particularly in dealings with retail clients.

The Australian financial services regulatory regime in turn adopts several forms of regulation of conflicts of interest, which are not wholly consistent in their scope and operation:

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[10] P Hanrahan, Background Paper 30 to the Royal Commission, Information about Selected Aspects of Foreign Financial Services Regulation, p 30.
[11] I have here drawn in part on my earlier paper, "Equitable and statutory regulation of conflicts of interests and duty Presentation at University of New South Wales Law School 10 May 2016", but also noted the many developments since that time.
[12] I MacNeil, "Rethinking Conduct Regulation", University of Glasgow, 2015.

Nature of duty	Source and application
Duty to avoid a real and sensible conflict of interest	General law - often applies to financial advisers as fact-based fiduciaries, unless excluded
Duties to act efficiently, honestly and fairly and to manage conflicts of interests	*Corporations Act* ss 912A(1)(a) and 912A(1)(aa) - applies to Australian financial services licence holders (but not directly to representatives or advice providers)
"Best interests" duties	*Corporations* Act s 961B - applies to providers of financial advice to retail clients[13]
Duty to prioritise client interests	*Corporations Act* s 961J - applies to providers of financial advice to retail clients[14]

The result of the general law and regulatory regime is that there can be situations where only a statutory duty applies, for example, where a relationship between an adviser and a client is not fiduciary, or a fiduciary duty is excluded, or the relevant conduct is not within the scope of any fiduciary duty. There can also be cases where both fiduciary and statutory duties apply, for example, where a fiduciary duty is not excluded or not effectively excluded and the relationship is an advisory relationship with a retail client.

Application of general law fiduciary duties to financial intermediaries and the scope of the duty

Turning now to the overlap between the statutory requirements and fiduciary duties in general law, some participants in the financial services industry, particularly trustees and stockbrokers (when in an agency relationship with their clients rather than dealing as counterparties) owe fiduciary duties because they fall within recognised traditional fiduciary categories.[15] Other participants in the financial services industry who are not status-based fiduciaries may owe a fiduciary duty on the facts of the particular relationship.[16]

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[13] A similar duty applies to superannuation trustees and directors of corporate trustees under the *Superannuation Industry (Supervision) Act* 1993 (Cth) ss 52(2)(c), 52A(2)(c).

[14] Similar duties apply to superannuation trustees and directors of corporate trustees and to life insurers and their directors under *SIS Act* s 52(2)(d), s 52A(2)(d) and *Life Insurance Act* 1995 (Cth) ss 32(1)(b), 48(2)(b).

[15] Traditional examples of such relationships include that between trustee and beneficiary, agent and principal, director and company, solicitor and client, and at least in some circumstances, an employee and his or her employer: *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41; [1984] HCA 64 per Gibbs CJ at 68.

[16] *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41; [1984] HCA 64 per Gibbs CJ at 68, per Mason J at 96-97; per Deane J at 141-142; *Breen v Williams* (1996) 186 CLR 71 ("*Breen v Williams*") per Gaudron & McHugh JJ at 106–10; *Bristol & West Building Society v Mothew* [1998] Ch 1 at 18; *Grimaldi v Chameleon Mining NL (No 2)* (2012) 200 FCR 296; [2012] FCAFC 6 at [174], [177]; *FHR European Ventures LLP v Cedar Capital Partners LLC* [2015] AC 250; [2014] UKSC 45. The question of when fiduciary duties are, or should be, recognised at general law has, of course, also given rise to a voluminous academic literature: PD Finn, *Fiduciary Obligations,* 1977; T Frankel, "Fiduciary Law" (1983)

The applicable principles are well-established but bears repeating. In *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41; [1984] HCA 64 ("*Hospital Products*"), Gibbs CJ observed (at 68) that the case law provided "no comprehensive statement of the criteria by reference to which the existence of a fiduciary relationship may be established". Mason J observed (at 96–97) that "the critical feature" of the traditional fiduciary relationship was the undertaking or agreement by the fiduciary to "act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense" and that:

> "The relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position … It is partly because the fiduciary's exercise of the power or discretion can adversely affect the interests of the person to whom the duty is owed and because the latter is at the mercy of the former that the fiduciary comes under a duty to exercise his power or discretion in the interests of the person to whom it is owed …"

Deane J similarly observed (at 141–142) that, although no single test would identify a fiduciary relationship:

> "There is, however, the notion underlying all the cases of fiduciary obligation that inherent in the nature of the relationship itself is a position of disadvantage or vulnerability on the part of one of the parties which causes him to place reliance upon the other and requires the protection of equity acting upon the conscience of that other ..."

In *Bristol & West Building Society v Mothew* [1998] Ch 1 (dealing with whether a solicitor's conduct amounted to breach of fiduciary duty), Millett LJ similarly observed (at 18) that:

> "A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of the fiduciary."

That observation has since been applied in numerous cases in the United Kingdom.[17]

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71 Calif L Rev 795; PD Finn, "The Fiduciary Principle" in T Youdan (ed), *Equity, Fiduciaries and Trusts*, 1989; PD Finn, "Contract and the Fiduciary Principle" (1989) 12 *UNSWLJ* 76; R Cooter & D Freedman, "The Fiduciary Relationship: Its Economic Character and Legal Consequences" (1991) 66 *NYU Law Rev* 1045; JR Macey and GP Miller, "An Economic Analysis of Conflict of Interest Regulation" (1997) 82 *Iowa LR* 965; DA DeMott, "Beyond Metaphor: An Analysis of Fiduciary Obligation" (1998) 37 *Duke LJ 879*; S Worthington, "Fiduciaries: When is Self-Denial Obligatory?" (1999) 58(3) *Camb LJ* 500; M Conaglen, "The Nature and Function of Fiduciary Loyalty" (2005) 121 *LQR* 452; M Conaglen, "Fiduciary Regulation of Conflicts between Duties" (2009) 125 *LQR* 111; M Leeming "The scope of fiduciary obligations: How contract informs, but does not determine, the scope of fiduciary obligations" (2009) 3 *J Eq* 181; M Conaglen, *Fiduciary loyalty: Protecting the due performance of non-fiduciary duties*, 2010; PD Finn, "Fiduciary Reflections" (2014) 88 *ALJ* 127.

[17] For other cases, see *Global Container Lines v Bonyad Shipping Co* [1998] 1 Ll Rep 528 at 546; *Arklow Investments Ltd v Maclean* [2000] 1 WLR 594 at 599; *Brandeis (Brokers) Ltd v Black* [2001] 2 All ER (Comm) 980 at [32]; *Daraydan Holdings Ltd v Solland International Ltd* [2004] EWHC 622 (Ch); [2005] Ch 119 at [55]; *Sinclair Holdings SA v Versailles Trade Finance Ltd* [2007] EWHC 915 (Ch) at [78]; [2007] 2 All ER (Comm) 993; *JD Wetherspoon plc v Van de Berg & Co Ltd* [2009] EWHC 639 (Ch) at [74]; *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45 at [5].

In *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)* (2007) 160 FCR 35; 62 ACSR 427("*Citigroup*") (dealing with whether an investment bank owed fiduciary duties to its takeover bidder client), Jacobson J referred, inter alia, to *Hospital Products* and observed (at [272]) that:

> "Apart from the established categories, perhaps the most that can be said is that a fiduciary relationship exists where a person has undertaken to act in the interests of another and not in his or her own interests but all of the facts and circumstances must be carefully examined to see whether the relationship is, in substance, fiduciary ..."

In *John Alexander's Clubs Pty Ltd v White City Tennis Club Ltd* (2010) 241 CLR 1; [2010] HCA 19 at [87], a unanimous High Court identified the 'critical feature' of fiduciary relationships as being that:

> "'the fiduciary undertakes or agrees to act *for or on behalf of* or *in the interests of* another person in the exercise of a *power or discretion* which will affect the interest of that other person in a legal or practical sense.' From this power or discretion comes the duty to exercise it in the interests of the person to whom it is owed."

In *Grimaldi v Chameleon Mining NL (No 2)* (2012) 200 FCR 296; [2012] FCAFC 6, the Full Court of the Federal Court (Finn, Stone and Perram JJ) observed (at [177]) that a fiduciary duty may exist:

> "when and insofar as that person has undertaken to perform such a function for, or has assumed such a responsibility to, another as would thereby reasonably entitle that other to expect that he or she will act in that other's interest to the exclusion of his or her own or a third party's interest."

Their Honours also noted (at [174]) that the relevant fiduciary duties were:

> "concerned with the setting of standards of conduct for persons in fiduciary positions. Its burden, put shortly, is with exacting disinterested and undivided loyalty from a fiduciary – hence, for example, its focus on conflicts between duty and undisclosed personal interest, conflicts between duty and duty and misuse of a fiduciary position for personal gain or benefit."

It is also well-established that a fiduciary obligation will arise only in relation to that part of the relationship which is fiduciary in character and the duty owed by a fiduciary will be limited to the scope of the service which it undertakes to provide.[18] A contract governing the relationship between the fiduciary and the beneficiary may also define the nature of the relationship and obligations between the parties in a way which limits the scope of any fiduciary duty.[19] Alternatively, the contract may authorise an act that would otherwise be a breach of fiduciary duty, so as to narrow the scope of that duty, or amount to informed consent or ratification.[20] The parties to a relationship may also seek expressly to provide that their relationship is not fiduciary in character, although

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[18] *Birtchnell v Equity Trustees Executors and Agency Co Ltd* (1929) 42 CLR 384 at 408 per Dixon J; *New Zealand Netherlands Society 'Oranje' Inc v Kuys* [1973] 1 WLR 1126 at 1130 per Lord Wilberforce; 0*Aequitas v AEFC* (2001) 19 ACLC 1006 at [307]; *Howard v Commissioner of Taxation* (2014) 309 ALR 1; [2014] HCA 21 at [34].

[19] *Hospital Products* per Mason J at 97; *News Ltd v Australian Rugby Football League Ltd* (1996) 64 FCR 410 at 539; *Breen v Williams* per Gummow J at 132–133; *Eric Preston Pty Ltd v Euroz Securities Ltd* (2010) 77 ACSR 135; [2010] FCA 97, aff'd (2011) 274 ALR 705; [2011] FCAFC 11.

[20] For example, in *National Nominees Ltd v Agora Asset Management Pty Ltd (No 2)* [2011] VSC 425.

the effectiveness of such a term has been controversial in the cases and the academic literature.[21]

These propositions are all illustrated by *Citigroup*, where the Federal Court of Australia considered, inter alia, the question whether an investment bank (Citigroup) owed fiduciary duties to its takeover bidder client (Toll) and specifically whether Citigroup had breached such a duty by allowing its proprietary trading desk to continue trading in shares in the target (Patrick) after it was mandated as adviser to Toll in the Patrick takeover. ASIC's claim for breach of fiduciary duty there failed because a mandate letter between Citigroup and Toll had successfully excluded the fiduciary duty.[22] Several other cases have recognised the possibility that the relationship between financial advisor and client may give rise to fiduciary duties.[23]

Within a fiduciary relationship, a fiduciary is required to act with undivided loyalty towards the beneficiary of the fiduciary duty in performing the duty.[24] However, the High Court has repeatedly emphasised that Australian law only recognises proscriptive or prohibitive duties, imposing the obligation on the fiduciary not to obtain an unauthorised profit or to be in a position of conflict, and the existence of a fiduciary relationship does not impose a positive legal duty on the fiduciary to act in the beneficiary's interests.[25] The "no conflict" rule is potentially the most demanding of the several duties that are potentially applicable in the financial sector, since it requires a fiduciary to avoid and not merely "manage" a conflict of interest or prioritise one interest over another.[26]

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[21] *South Sydney District Rugby League Football Club Ltd v News Ltd* (2000) 177 ALR 611 at [134]–[135]; *Citigroup* at [296], [337]; P Finn, "Fiduciary Reflections" (2014) 88 *ALJ* 127; M Leeming, "The scope of fiduciary obligations: How contract informs, but does not determine, the scope of fiduciary obligations" (2009) 3 *J Eq* 181.

[22] The result is vigorously criticised in PD Finn, "Fiduciary Reflections" (2014) 88 *ALJ* 127 and, in response, equally vigorously defended in A Eastwood & L Hastings "A response to Professor Finn's 'Fiduciary Reflections'" (2014) 98 *ALJ* 314.

[23] *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390; [1991] FCA 375; *Aequitas Ltd v Sparad No 100 Pty Ltd (formerly Australian European Finance Corp Ltd)* (2001) 19 ACLC 1006; [2001] NSWSC 14; *Citigroup* at [282]–[286], [325]–[330]; *Wingecarribee Shire Council v Lehman Bros Australia Ltd (in liq)* (2012) 301 ALR 1; [2012] FCA 1028 at [732]; *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, on appeal in *ABN Amro Bank NV v Bathurst Regional Council* (2014) 309 ALR 445; [2014] FCAFC 65. For a sample of the academic literature, see JE Fisch & HA Sale, "The securities analyst as agent: Rethinking the regulation of analysts" (2003) 88 *Iowa L Rev* 1035; A Tuch, "Investment Banks as Fiduciaries: Implications for Conflicts of Interest" (2005) 29 *Melb U L Rev* 478; A Tuch, "Obligations of financial advisors in change-of-control transactions: Fiduciary and other questions" (2006) 24 *C&SLJ* 488; JE Fisch "Fiduciary duties and the analyst scandals" (2007) 58 *Ala L Rev* 1083; V Battaglia, "Dealing with Conflicts: The equitable and statutory obligations of financial services licensees" (2008) 26 *C&SLJ* 483; K Lindgren, "Fiduciary duty and the Ripoll Report" (2010) 28 *C&SLJ* 435; P Hanrahan "The relationship between equitable and statutory 'best interests' obligations in financial services law" (2013) 7 *J Eq* 46; M Scott Donald "Regulating for fiduciary qualities of conduct" (2013) 7 *J Eq* 142; P Latimer "Protecting the best interests of the client" (2014) 29 *AJCL* 8; S Degeling and J Hudson, "Fiduciary obligations, financial advisers and FOFA" (2014) 32 *C&SLJ* 527.

[24] *Bristol & West Building Society v Motthew* at 18–19; *Maguire v Makaronis* (1997) 188 CLR 449 at 465; *Bofinger v Kingsway Group* [2009] HCA 44; (2009) 239 CLR 269 at [49]; J Campbell, "Fiduciary Relationships in a Commercial Context", Sydney Law School, Legal Studies Research Paper, No 14/26.

[25] *Breen v Williams*; *Pilmer v Duke Group Ltd (in liq)* (2001) 207 CLR 165 at 197–8; [2001] HCA 31.

[26] *Aberdeen Railway Co v Blaikie Brothers* (1854) 1 Macq 461 at 471; *Boardman v Phipps* [1967] 2 AC 46 at 124; *Chan v Zacharia* (1984) 154 CLR 178 at 198.

Three examples

I now turn to three examples of the application of these principles in litigation in the financial sector. First, in *Eric Preston Pty Ltd v Euroz Securities Ltd* (2010) 77 ACSR 135; [2010] FCA 97, aff'd (2011) 274 ALR 705; [2011] FCAFC 11, the plaintiff ("Eric Preston") alleged that the defendant ("Euroz") breached, inter alia, fiduciary duties in advising it to enter into a securities lending & borrowing agreement with Opes Prime, which exposed Eric Preston to substantial loss when Opes Prime was placed in liquidation in the global financial crisis. Eric Preston alleged that Euroz owed it fiduciary duties as its "stockbroker and financial advisor" and that it breached these duties by not advising Eric Preston as to the risks of the Opes Prime facility. There were factual difficulties with that claim which I need not address. Relevantly, for present purposes, Siopis J held that the fiduciary relationship must "accommodate itself to the terms of the contract between the parties". His Honour held, citing *Hospital Products*, that it was not a term of the retainer that Euroz would act as financial advisor to Eric Preston so there could be no fiduciary obligation to that effect. Siopis J also held, citing *Breen v Williams*, that, even if Eric Preston had proved that it was a term of the retainer that Euroz would act as Eric Preston's financial advisor and that it owed the alleged fiduciary obligations to Eric, those obligations would not give rise to positive duties of investigation and advice as to the nature of the Opes Prime facility and the financial state of Opes Prime, since fiduciary obligations are proscriptive (ie. the fiduciary must not obtain any unauthorised benefit from the relationship and must not be in a position of conflict) but not prescriptive (in the sense that the fiduciary is not required to act in the interests of the person to whom the duty is owed). That decision was upheld on appeal to the Full Court of the Federal Court.

Claims for breach of fiduciary duty were also brought and succeeded in at least two claims brought after the local financial crisis arising from the sale of complex financial products to local councils. In *Wingecarribee Shire Council v Lehman Bros Australia Ltd (in liq)* (2012) 301 ALR 1; [2012] FCA 1028 ("*Wingecarribee Shire Council*"), a group of municipal councils brought representative proceedings against the defendant (formerly known as Grange Securities Limited ("Grange")) in respect of the sale of synthetic collateralised debt obligations ("SCDOs"). Some of those products had lost some or all of their value following the global financial crisis and the repayment of capital in other products would potentially be delayed by several years. The councils claimed that Grange acted, inter alia, in breach of fiduciary duty in recommending, and advising on (or, in the case of two councils, using a power under Individually Managed Portfolio Agreements ("IMPAs") to make) investments in the SCDOs.

Rares J did not there specifically distinguish between the fiduciary duty applicable in a traditional fiduciary relationship, such as agency, and the ad hoc fiduciary duty which may arise in non-traditional arrangements, typically involving an undertaking to act in the interests of the other party. His Honour held that Grange breached fiduciary duties owed as a financial adviser and also owed to the two councils under the IMPAs in making investments as their agent. His Honour found a breach of the prohibition on conflicts of interest by reason of a conflict between Grange's duty to give sound financial advice to, or make investment decisions on behalf of, the councils and an undisclosed interest in earning large fees or profits in sales of SCDOs.

In *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200, Jagot J dealt with a very complex series of claims and cross claims arising from the sale of complex structured financial products titled "Constant Proportion Debt Obligations" ("CPDOs"). The defendants were Local Government Financial

Services Pty Ltd ("LGFS"), an Australian financial services licensee that had acquired the CPDOs and onsold them to local councils; ABN Amro, an investment bank that had designed and distributed the products; and Standard & Poors ("S&P"), a credit rating agency that had been retained by ABN Amro to rate the products. A CPDO was, broadly, a credit derivative involving a notional 10 year product credit default swap referencing two credit swap indices. The products were rated "AAA" by S&P and marketed with S&P's consent on that basis. The councils brought and succeeded on several claims. Relevantly for our purposes, the councils contended that LGFS owed fiduciary duties as their financial adviser and had breached them. Jagot J held (in similar reasoning to *Wingecarribee Shire Council*) that a fiduciary relationship existed and a LGFS breached the prohibition on conflict of interest by reason of undisclosed commercial pressures upon it to distribute the products in order to restore the success of its business. Arguably, that finding should be treated as confined to an interest in the sale of the products which is out of the ordinary course. The Full Court of the Federal Court largely dismissed an appeal from that decision in *ABN Amro Bank NV v Bathurst Regional Council & Others* (2014) 309 ALR 445; [2014] FCAFC 65.

In *Porter v Mulcahy & Co Accounting Services Pty Ltd* [2021] VSC 572, in the somewhat different context of a claim for breach of fiduciary duties against an accountant, Delaney J referred (at [488]) to *Wingecarribee Shire Council* in summarising the applicable principles in orthodox terms:

> "The relationship between a professional advisor and client, including that of accountant and client, does not fall within one of the established categories of fiduciary relationships. However, the categories of fiduciary relationships are not closed. The relationship between accountant and client may give rise to a fiduciary relationship where the 'critical features of those established relationships' are found to exist. Ad hoc fiduciary relationships are 'infinitely varied', with the scope of the duties owed pursuant to such relationships determined by the facts.
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> A fiduciary relationship can be found or implied from the circumstances. There is no requirement that there be any form of contract (such as a retainer) or formal legal relationship between the parties to establish a fiduciary duty."

Exclusion of fiduciary duties by contract

The effectiveness of fiduciary duties as a means of regulation of financial services is potentially limited by the fact that they may be excluded by contract, as they were in *Citigroup*, although attempts to exclude them will not always succeed, particularly in dealings with retail investors.[27] The statutory duties which I note below go some way to addressing that limitation.

Duties to act efficiently, honestly and fairly, and to manage conflicts (s 912A(1)(a)–(aa))

Many participants in the financial services industry are required to hold Australian financial services licences and are subject to the conduct of business requirements applicable to such licensees. Section 912A(1)(a) of the *Corporations Act* requires a financial services licensee to do all things necessary to ensure that the financial

[27] S Degeling and J Hudson, "Fiduciary obligations, financial advisers and FOFA" (2014) 32 *C&SLJ* 527.

services covered by the licence are provided efficiently, honestly and fairly. This is a broad and open standard, which can be breached by a range of improper conduct.[28]

In *Australian Securities and Investments Commission v Camelot Derivatives Pty Ltd (in liq)* (2012) 88 ACSR 206; [2012] FCA 414, this standard was contravened by trading that involved 'churning', by which an adviser promoted trading which was excessive in the light of the client's trading objectives. The court accepted ASIC's submissions as to the applicable principles as follows:

> "(1) the words 'efficiently, honestly and fairly' must be read as a compendious indication describing 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 …;
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> (2) the words 'efficiently, honestly and fairly' connote a requirement of competence in providing advice and in complying with relevant statutory obligations …;
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> (3) the word 'efficient' refers to a person who performs his duties efficiently, meaning the person produces the desired effect, and is capable and competent … Inefficiency may be established by demonstrating that the performance of a licensee's functions falls short of the reasonable standard of performance by a dealer that the public is entitled to expect …;
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> (4) it is not necessary to establish dishonesty in the criminal sense ... The word 'honestly' may comprehend conduct which is not criminal but which is morally wrong in the commercial sense …; and
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> (5) the word 'honestly' when used in conjunction with the word 'fairly' tends to give the flavour of a person who not only is not dishonest, but also is ethically sound." [Citations omitted.][29]

At first instance in *Australian Securities and Investments Commission v Westpac Securities Administration Ltd* (2018) 133 ACSR 1; [2018] FCA 2078, and on appeal in *Australian Securities and Investments Commission v Westpac Securities Administration Ltd* [2019] FCAFC 187, the Court held that a marketing campaign in respect of the consolidation of superannuation accounts contravened the "efficiently, honestly and fairly" requirement in this section. On appeal, Allsop CJ described the "efficiently, honestly and fairly" standard as "part of the statute's legislative policy to require social and commercial norms or standards of behaviour to be adhered to" and as directed to a "social and commercial norm", and held (at [174]) that the licensee's conduct was not "fair" in seeking to influence customers to make decisions on the basis of general advice when those decisions could only prudently be made with regard to information personal to the customers. Contrary to earlier case law, O'Bryan J there questioned (at [426]) the longstanding view that the "efficiently, honestly and fairly" standard represents a single compendious standard, with those terms being read together, and observed that

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[28] *Story v NCSC* (1988) 13 NSWLR 661; 13 ACLR 225; 6 ACLC 560; *R J Elrington Nominees Pty Ltd v Corporate Affairs Commission (SA)* (1989) 1 ACSR 93; *Saxby Bridge Financial Planning Pty Ltd and ASIC* (2003) 46 ACSR 286; [2003] AATA 480, aff'd (2003) 47 ACSR 649; [2003] FCAFC 244. For commentary, see A Black and P Hanrahan, *Securities and Financial Services Law*, 10th ed, [10.18]; P Latimer, "Providing Financial Services 'Efficiently, Honestly and Fairly': Pt 2 (2020) 37 *C&SLJ* 382; J Anderson "Duties of Efficiently, Honesty and Fairness Post-Westpac: A New Beginning for Financial Services Licensees and the Courts?" (2020) 37 *C&SLJ* 450; P Latimer "Providing Financial Services 'Efficiently, Honestly and Fairly': Pt 3" (2022) 39 *C&SLJ* 160.

[29] For another summary of these principles, see *Australian Securities and Investments Commission v RI Advice Group Pty Ltd* (2022) 160 ACSR 204; [2022] FCA 496 at [30].

these three concepts are not inherently in conflict and that the ordinary meaning of the phrase 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".

In *Australian Securities and Investments Commission* v *AGM Markets Pty Ltd (in liq) (No 3)* (2020) 380 ALR 27; 143 ACSR 140; [2020] FCA 208 at [505]-[528], Beach J continued to treat that standard as a single compendious standard, with the terms "efficiently, honestly and fairly" being read together, and held that the standard may be breached by unintentional conduct, and contravention may be established by objective analysis, although evidence of intention may be relevant.[30]

Other recent examples of cases in this area include *Australian Securities and Investments Commission v MLC Nominees Pty Ltd* (2020) 147 ACSR 266; [2020] FCA 1306 (misleading misrepresentations to members of superannuation funds as to the entitlement to charge plan service fees and members' obligation to pay those fees) and *Australian Securities and Investments Commission v National Australia Bank Ltd* [2022] FCA 1324. On the other hand, a contravention of the section was not established in *Australian Securities and Investments Commission v Commonwealth Bank of Australia* [2022] FCA 1422, which involved errors in a large number of transactions that constituted a small proportion of total transactions, and where CBA had taken steps to investigate the error and remediate affected customers when it was identified. Downes J there noted (at [161]) that the "efficiently, honestly and fairly" standard did not require systems and processes in which errors would never occur. In *Australian Securities and Investments Commission (ASIC) v Diversa Trustees Ltd* [2023] FCA 1267, a trustee of a superannuation fund was not held to have contravened the section by reason of a third party service provider's conduct in promoting its products. In *Australian Securities and Investments Commission (ASIC) v Lanterne Fund Services Ltd* [2024] FCA 353, a defendant which held an AFSL and authorised other companies and individuals to operates as its authorised representatives contravened that section by failing to have adequate systems, processes and controls in place; and, in *Australian Securities and Investments Commission v Macquarie Bank Ltd* [2024] FCA 416, a penalty was imposed for an admitted contravention of s 912A of the *Corporations Act*, by reason of the Bank's failure to have adequate systems to prevent or detect fraudulent transactions by third parties in cash management accounts.

The limited sanctions previously applicable to a breach of the "efficiently, honestly and fairly" requirement could not practically be implemented against the larger Australian banks and financial institutions. The introduction of civil penalties for breach of the "efficiently, honestly and fairly" standard may partly address that issue, subject to the continuing difficulty (also evidence in international experience) that recurrent penalties become a cost of business that is ultimately paid by consumers or shareholders, to which I return below.

Section 912A(1)(aa) in turn requires a financial services licensee to have in place adequate arrangements for managing conflicts of interest that arise wholly, or partly, in

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[30] That approach was followed in *Australian Securities and Investments Commission v Commonwealth Bank of Australia* [2020] FCA 790 at [50] and again in *Australian Securities and Investments Commission v National Australia Bank Ltd* (2022) 164 ACSR 358; [2022] FCA 1324 at [350]-[352].

their financial services business.[31] There are significant differences between this duty and the equitable duty, including that that duty contemplates that a conflict will be *"manage[d]"* rather than necessarily avoided, and that duty cannot be excluded by contract although disclosure (including within the terms of the contract) may be a means of managing a conflict. In *Citigroup*, Jacobson J held that the concept of 'managing' conflicts of interest assumes that potential conflicts will exist which must be managed by adequate arrangements rather than totally eliminated. His Honour there held (at [445], [452]) that Citigroup's arrangements as to information barriers and for identification and management of conflicts were adequate and an answer to an alleged contravention of that obligation.

For completeness, the Australian Law Reform Commission ("ALRC") recently expressed concern as to the complexity of these sections, and their overlap with specific conduct of business requirements and the prohibitions on unconscionable conduct and misleading and deceptive conduct.[32] The ALRC initially recommended that each of the three elements of s 912A, which are presently read as a compendious requirement, should be treated as standalone obligations; that the word "efficiently" should be replaced with the word "professionally", without changing the scope of that concept; and specific obligations (including ss 912A(1)(aa) and 912A(1)(e)-(f) and (h)) which overlap with the general requirement should be repealed. That suggestion was met with, at best, a mixed response in submissions and academic commentary[33] and the ALRC's Final Report indicates that it has not been "formalised" as a recommendation.

Statutory best interests duty and related obligations

The best interest duty

Part 7.7A Div 2 of the *Corporations Act*, introduced following the global financial crisis and associated losses suffered by Australian retail investors by the FOFA reforms, requires a provider of financial advice to take reasonable steps to act in the best interests of its retail client and to place the client's interests ahead of its own when providing personal advice to that retail client.[34]

Section 961B(1) requires a provider of personal advice to a retail client to act in the best interests of the client when giving the advice. Section 961B(2) then specifies several steps that an adviser may take in order to satisfy the best interests duty, and s 961B(2)(g) requires that, in order to comply with the best interests duty, an adviser must have:

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[31] For discussion of this requirement, see A Black and P Hanrahan, *Securities and Financial Services Law*, 10th ed, [10.20]ff; G Pearson, *Financial Services Law and Compliance in Australia*, 2009, [4.3.34], [4.4], [4.4.5]–[4.4.6]; J Moutsopoulos, "Finance Industry has Duty to Manage Conflicts" (2005) *IFLR* 41; P Latimer, "Providing Financial Services 'Efficiently, Honestly and Fairly'" (2006) 24 *C&SLJ* 362; V Battaglia, "Dealing with conflicts: The equitable and statutory obligations of financial services licensees" (2008) 26 *C&SLJ* 483.
[32] ALRC Interim Report A (November 2021).
[33] See, for example, the criticisms in P Latimer, "Providing Financial Services 'efficiently, honestly and fairly': Part 3" (2022) *C&SLJ* 160.
[34] For commentary, see H Liu et al "In Whose Best Interests? Regulating Financial Advisers, the Royal Commission and the Dilemma of Reform" (2020) 42 *Syd LR 37*; C Byrne "The Liability of Directors and Officers When AFS Licences Provide Defective Product Advice" (2022) 39 *C&SLJ* 19; I Ramsay & M Webster, "Enforcement Action by the Australian Securities & Investments Commission in Relation to Financial Adviser Misconduct" (2022) 39 *C&SLJ* 225.

"taken any other step that, at the time the advice is provided, would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances."

On its face, and if it stood alone, s 961B(1) would resemble other statutory provisions that require a person to have regard to the "best interests" of another.[35] However, the operation of s 961B(1) is narrowed by s 961B(2) since taking the steps specified in s 961B(2) is treated as compliance with the "best interests" duty specified in s 961B(1). The requirement in s 961B(2)(g) that an adviser take any other step that would reasonably be regarded as in the client's best interests presently preserves a wider scope for s 961B(2), since a step that is not specified in the previous steps set out in the section may nonetheless be reasonably regarded as being in the client's best interests.

The scope of the section was considered in *Australian Securities and Investments Commission (ASIC) v NSG Services Pty Ltd* (2017) 122 ACSR 47; [2017] FCA 345 ("*NSG Services*"), where the Court granted declaratory and other relief by consent in respect of contraventions of Pt 7.7A Div 2, including representatives' failure to comply with s 961B in respect of personal advice provided to retail clients. Moshinsky J there left open the correctness of the parties' view that s 961B was concerned with the process or procedure adopted in providing advice and s 961G (noted below) with the content or substance of the advice; see also *Australian Securities and Investments Commission v Financial Circle Pty Ltd* (2018) 123 ACSR 624; [2018] FCA 2.

In the Full Court of the Federal Court in *Australian Securities and Investments Commission v Westpac Securities Administration Ltd* (2019) 272 FCR 170; 373 ALR 455; 141 ACSR 1; [2019] FCAFC 187, the Full Court held that a marketing campaign in respect of the consolidation of superannuation accounts failed to comply with the "best interests" duty under this section and also upheld the finding at first instance that that marketing campaign had contravened the "efficiently, honestly and fairly" requirement in s 912A of the *Corporations Act*. Allsop CJ (at [10]) and by Jagot J (at [301]) observed that the duty requires a provider to "have as its purpose or object acting in the best interests of the client", and that a provider can prove that purpose by taking the steps specified in 961B(2) which are essentially procedural in nature. O'Bryan J (at [405) observed that the section is not directed to "whether the substance of the advice is in the best interests of the client" but rather to "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 that advice.[36]

Importantly, compliance with the statutory "best interests" duty will not, in itself, comply with the general law duty to avoid either an actual conflict of interest or a real and sensible possibility of conflict of interest. The fact that the steps specified in s 961B(2) of the *Corporations Act* were taken does not seem capable of avoiding any breach of the no conflict rule arising from the fact that advice is given in a conflicted setting. However, efforts made by advisers and their representatives to comply with the statutory standards may tend to reduce the risk of breach of the general law fiduciary

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[35] For example, s 601FC(1)(c) of the *Corporations Act* requires a responsible entity, in exercising its powers and carrying out its duties, to "act in the best interests of the members and, if there is a conflict between the members' interests and its own interests, give priority to the members' interests".
[36] The High Court dismissed an appeal from that decision in *Westpac Securities Administration Ltd v Australian Securities and Investments Commission* (2021) 270 CLR 118; (2021) 387 ALR 1; (2021) 150 ACSR 125; [2021] HCA 3, limited to the question whether Westpac had given "personal advice" for the purposes of s 766B(3)(b) of the *Corporations Act*.

duties, and the risk of regulatory action to the extent that the relevant regulators may give particular attention to the statutory duties.

Section 961G of the *Corporations Act* in turn provides that a financial adviser may only provide advice to a retail client (as defined in s 761G) if it would be reasonable to conclude that the advice would be appropriate to the client, had the provider satisfied the best interests obligation under s 961B. The scope of this section was also considered in *NSG Services* where, as I noted above, Moshinsky J left open the correctness of the parties' view that this section rather than s 961B was concerned with the content or substance of the advice. Other recent cases include *Australian Securities and Investments Commission v RI Advice Group Pty Ltd (No 2)*; (2021) 156 ACSR 371; [2021] FCA 877; *Australian Securities and Investments Commission v Dixon Advisory & Superannuation Services Ltd* [2022] FCA 1105 ("*Dixon Advisory & Superannuation Services*") and *Australian Securities and Investments Commission (ASIC) v DOD Bookkeeping Pty Ltd (in liq)* [2023] FCA 1622.

Conflicted remuneration

Financial services licensees, their authorised representatives and representatives are also not permitted to accept "conflicted remuneration" (as defined): ss 963E. A licensee must take reasonable steps to ensure that its representatives do not accept conflicted remuneration: s 963F contraventions of this section were established in *Australian Securities and Investments Commission v Forex Capital Trading Pty Ltd* [2021] FCA 570 and *Australian Securities and Investments Commission v Select AFSL Pty Ltd (No 2)* (2023) 162 ACSR 1; [2022] FCA 786. In *Australian Securities and Investments Commission v RM Capital Pty Ltd* [2024] FCA 151, a contravention of this section was established where a licence holder authorised a corporate authorised representative to provide financial product advice and that representative accepted conflicted remuneration as to advice of self-managed superannuation funds to acquire property.

Employers of licensees or representatives must not give them conflicted remuneration for work carried out by them as an employee: s 963J; contraventions of this section were established in *Australian Securities and Investments Commission v Forex Capital Trading Pty Ltd* above; *Australian Securities and Investments Commission v Select AFSL Pty Ltd (No 2)* above.

A product issuer must also not give conflicted remuneration to a licensee or its representative: s 963K. *In Australian Securities and Investments Commission v Westpac Banking Corp (Omnibus)* (2022) 159 ACSR 381; [2022] FCA 515 at [94], Beach J summarised the elements of a contravention of s 963K as that (1) an issuer or seller of a financial product gives a "benefit" to a financial services licensee or a representative of a financial services licensee; (2) the financial services licensee or representative provides financial product advice to persons as retail clients; and (3) because of the nature of the benefit or the circumstances in which it was given, the benefit could reasonably be expected to influence the choice of financial product recommended by the licensee or representative to retail clients or to influence the financial product advice given to retail clients by the licensee or representative. The scope of this section was also considered in *Australian Securities and Investments Commission v Commonwealth Bank of Australia* (2023) 163 ACSR 442; [2022] FCA 1149, where ASIC failed to establish that the Commonwealth Bank had contravened either the prohibition against accepting conflicted remuneration under s 963E of the *Corporations Act*, and also failed to establish that a subsidiary of the Bank had contravened the prohibition on product issuers or sellers giving conflicted remuneration

under s 963K of the *Corporations Act*. The Full Court of the Federal Court dismissed an appeal from that decision in *Australian Securities and Investments Commission v Commonwealth Bank of Australia* [2023] FCAFC 135, although it took a different view to that taken by the primary judge in respect of several issues.

Prioritising client interests

Other provisions in the *Corporations Act* adopt the concept of "prioritising" client interests, which is an alternative to, and seems to be a less demanding standard than, avoidance of conflicts of interest. For example, s 961J of the *Corporations Act* requires a person who provides financial advice to a retail client to "give priority" to the interests of the retail client when giving advice where it knows, or reasonably ought to know, there is a conflict between the interests of the client and those of the provider, licensee, authorised representative or their associates. The payment of commission to a representative can give rise to a conflict of interest between the interests of that representative and the interests of consumers within the meaning of that section: *Australian Securities and Investments Commission v Ultiqua Lifestyle Promotions Ltd (in liq)* (2022) 159 ACSR 195; [2022] FCA 561 at [87]; a claim for a contravention of the section was not pressed in *Dixon Advisory & Superannuation Services Ltd*. One commentator has pointed out that the language of this section is "open textured"[37], with the advantage that it will be capable of applying in a range of circumstances, and the corresponding disadvantage that there may be uncertainty, or at least room for factual debate, as to whether conduct gave "priority" to a client's interests in any particular case. A duty to give priority to a client's interests appears to assume the coexistence of two interests, that of the client and another interest, and to be satisfied by preferencing the client's interest while still having regard to the other interest.

Design and distribution obligations and production intervention orders

I should say something further as to the design and distribution obligations in Pt 7.8A of the *Corporations Act*, relating to financial products for retail clients, which were introduced by the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act* 2019 (Cth).[38] These obligations broadly correspond to the "financial product governance" requirements which have been introduced in the United Kingdom and the European Economic Union.

These provisions are a step away from the prior disclosure-based regime, which did not limit retail clients' access to complex products, and relied on a combination of product disclosure and, where personal advice was given, suitability and now "best interest" requirements. That approach reflected a policy view that properly informed clients can make rational choices as to the nature of the products they require and as to pricing. There are plainly reasons to doubt that view, wider developments in behavioural finance; the evident failures of decision-making, including by wholesale investors, in the period leading up to the global financial crisis; and, in Australia, the recurrent losses to investors to which I have referred above.

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[37] M Scott Donald, "Regulating for fiduciary qualities of conduct" (2013) 7 *J Eq* 142 at 147.
[38] I have here drawn on my paper, "Design and Distribution Obligations and Product Interventions Powers", delivered at the Corporate Law Workshop 2018; C Chong, The Design and Distribution Obligations: An Effective Tool for Consumer Protection? (2023) 40 C&SLJ 83.

The regime requires the preparation of target market determinations for products within the proposed regime and imposes further obligations as to the distribution of relevant financial products. Broadly, distributors are required to put in place reasonable controls to ensure products are distributed in accordance with the identified target markets and comply with reasonable requests for information from the issuer in relation to the review of the products. The regime is complex, reflecting the use of several complex defined terms, which in turn adopt definitions used elsewhere in Ch 6D and Ch 7, but often vary them so that they operate in a wider or narrower way than in those Chapters. The regime is also replete with criminal penalty consequences and offences arising from non-compliance.

There are now several cases dealing with this regime. First, s 994B of the *Corporations Act* requires a person to make a target market determination ("TMD") in specified circumstances. In *Australian Securities and Investments Commission v Bit Trade Pty Ltd* [2024] FCA 953, the Federal Court held that a margin extension in a national currency was a credit facility for the purposes of s 12BAA of the *Australian Securities and Investments Commission Act* 2001 (Cth) ("*ASIC Act*") and that Bit Trade had contravened s 994B of the *Corporations Act* by making a margin extension product available to customers trading on a crypto currency exchange, without making the required TMD.

Second, in *Australian Securities and Investments Commission v American Express Australia Ltd* [2024] FCA 784, the Federal Court imposed a substantial penalty in respect of an admitted contravention of s 994C(4) of the *Corporations Act*[39] in respect of credit cards primarily distributed through retail stores, where American Express had failed to cease retail product distribution where it knew, or ought reasonably to know, that the TMD was no longer appropriate. The Court there held that s 994C(5) of the *Corporations Act*[40] was not contravened, where the parties agreed that American Express did not have actual knowledge that the TMDs for the relevant cards were no longer appropriate.

Third, a person to whom the design and distribution obligations apply also contravenes s 994E(3) of the *Corporations Act* if it fails to take reasonable steps that would result in, or would be reasonably likely to result in, retail product distribution conduct of a financial product being consistent with the TMD. A contravention of that section was established in *Australian Securities and Investments Commission v Firstmac Ltd* [2024] FCA 737, where Firstmac distributed both term deposit products with a capital guarantee and a short investment term and other products. As those term deposits neared maturity, Firstmac sent emails to depositors containing an application form, product disclosure statement and other information for its "High Livez" product which was not capital guaranteed and had a longer target investment term. Firstmac's staff failed to take, or at least regularly take, planned steps to ensure that that information was only sent to

[39] Section 994C(4) provides, inter alia, that, if a person who has made a TMD knows, or ought reasonably to know, that an event or circumstance has occurred that would reasonably suggest that the TMD is no longer appropriate, then, from as soon as practicable (but no later than 10 business days after the person first knew of the occurrence of that event or circumstance) that person must not engage in retail product distribution conduct until it has taken specified steps.

[40] Section 994C(5) requires that, if the person who has made the TMD the person *knows* that, inter alia, an event or circumstance has occurred that would reasonably suggest that the TMD is no longer appropriate, it must take all reasonable steps to ensure that regulated persons who engage in retail product distribution conduct are informed that they must not engage in that conduct until specified steps are taken.

persons who did not seek a capital guarantee and shorter investment term. Downes J there held that the requirements in s 994E(3) directed to conduct that (1) "would have resulted in" or (2) "would have been reasonably likely to have resulted in" distribution conduct being consistent with the TMD were two alternative tests, rather than a compound requirement, so that Firstmac would have avoided a contravention of the section if it complied with either requirement. Her Honour considered the obligation under the section required the regulated person to take reasonable steps that would result in a real, and not fanciful or remote, chance that the distribution conduct would not be inconsistent with the TMD having regard to the entity's policies, procedures and contracts, assessed objectively. Her Honour also held that such reasonable steps must be taken before a regulated person engages in the relevant distribution conduct, here the provision of the product disclosure statement for the High Livez products. Her Honour found that Firstmac here contravened s 994E(3) of the *Corporations Act* where the steps that it had taken left open a real chance that term deposit holders who required a capital guarantee and a short investment term would receive information concerning the "High Livez" product, although they were outside its target market.

Part 7.9A of the *Corporations Act* in turn deals with product intervention orders, which allow ASIC to intervene in relation to a product (or class of products) where ASIC is satisfied that the product (or class of products) has resulted in, or is likely to result in, significant consumer detriment to retail clients. These provisions have now been used and have generated some case law.[41]

There are real potential benefits of these regimes, despite their complexity. The design or means of distribution of investment products can take advantage of information disadvantages of retail investors, which could notionally be addressed by disclosure; behavioural biases, which could not readily be addressed by disclosure; and other deficiencies in distribution mechanisms, for example, inappropriate recommendations by advisers, where advice is sought. These issues are exacerbated because many Australian investors do not seek advice from financial advisers, partly because of a historical perception that advice is or should be provided for free (or, more accurately, be funded from charges included in the price of the product). Even if advice is obtained, and despite the Future of Financial Advice Reforms, conflicts may still adversely affect the advice that is provided. In these circumstances, there is a strong case for design and distribution obligations or product intervention powers or both. Both can protect retail investors where suitability and best interest requirements do not apply, because products are distributed directly to consumers without the intervention of personal financial advice. Both can also provide means to address areas where financial incentives distort recommendations by advisers or investors do not take or do not understand advice before investing.

ASIC's approach to litigation, enforceable undertakings and penalties and the Financial Accountability Regime

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[41] For example, *Cigno Pty Ltd v Australian Securities and Investments Commission* [2020] FCA 479; appeal dismissed in *Cigno Pty Ltd v Australian Securities and Investments Commission* (2021) 287 FCR 650; [2021] FCAFC 115; leave to appeal refused [2022] HCATrans 224; for subsequent cases as to credit licensing requirements, see *Australian Securities and Investments Commission v BHF Solutions Pty Ltd* (2022) 293 FCR 330; (2022) 410 ALR 390; (2022) 162 ACSR 266; [2022] FCAFC 108; *Australian Securities and Investments Commission v BHF Solutions Pty Ltd (No 2)* (2023) 168 ACSR 512; [2023] FCA 787.

The Royal Commission recommended that ASIC should adopt an approach to enforcement that takes, as its starting point, the question of whether a Court should determine the consequences of a contravention and emphasised that increased litigation may vindicate a legal principle and will have deterrent effect. The Government accepted that recommendation and ASIC for a time indicated that it would adopt a "why not litigate?" enforcement stance. There are, of course, some good answers to the question "why not litigate?", by reference to issues of delay, cost, uncertainty of outcome and the risk that that approach will encourage an equally litigious approach by regulated entities. In the event, ASIC now adopts a more nuanced position.

At least since the Royal Commission, and as we have seen above, ASIC has brought numerous cases against providers of financial services, particularly to the duties to act efficiently, honestly and fairly and to manage conflicts (s 912A(1)(a)–(aa)) and the statutory best interest duty requirement and associated provisions under Pt 7.7A Div 2 of the *Corporations Act*. Some of the cases against providers of financial services reflect misconduct in its usual sense and others reflect system failures. There seems to be a real prospect that these cases will now be a permanent feature of the landscape, with recurrent breaches arising from complexity in systems in financial institutions. The penalties applicable to breach of many provisions of the *Corporations Act* have been substantially increased, and the provisions to which they apply extended, including by *The Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act* 2019 (Cth), which extended the range of provisions under the *Corporations Act* to which the civil penalty regime applies and introduced civil penalties for, among other things, the obligations of an Australian financial services licensee not being carried out 'efficiently, honestly and fairly' under s 912A of the *Corporations Act*, the breach reporting obligations under s 912D of the *Corporations Act* and provisions relating to the handling of client monies.

There remain substantial difficulties with greater reliance on litigation and increased penalties, at least in the case of major financial institutions, which have received substantial international attention.[42] The utility of more litigation or increased penalties is limited by the practical reality that it will generally not be possible be possible to impose a sanction that would substantially prejudice the operation of one of the four major banks or (as is emphasised by the fact that they have traditionally been referred to as the "four pillars" of the Australian banking system) or larger superannuation or insurance companies, if that had the capacity to cause their failure. There is also a risk and indeed a likelihood (not unique to Australia) that fines imposed on financial intermediaries following successful proceedings, however large, are ultimately a cost of business that is borne by consumers of the financial institution's services or by its shareholders.[43] Importantly, the former Banking Executive Accountability Regime and the Financial Accountability Regime largely avoid those difficulties and should

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[42] For example, GM Gilchrist, "The Special Problem of Banks and Crime" (2014) 85 *U Colo L Rev* (observing that the non-prosecution of banks is often justified by externalities arising from their fragility and systemic importance; that it is less clear why bank employees have not been prosecuted individually; and that the criminal law may not be the most effective tool to address bank misconduct).

[43] MR Reiff, "Punishment in the executive suite: Moral responsibility, causal responsibility and financial crime" in L Herzog (ed), *Finance in a Just Society*, 2017, p136.

incentivise executives of banks and financial institutions to assume, rather than displace, responsibility.[44]

ASIC can also accept an "enforceable undertaking" as an alternative to bringing court proceedings.[45] A breach of an enforceable undertaking exposes the party who gave it to liability to pay the amount of any financial benefit attributable to that breach to the Commonwealth, and to compensate any other person who suffered loss or damage as a result of the breach, and to any other order which the court considered appropriate. That regime functioned similarly to the deferred prosecution regime in the United States and the United Kingdom, which is also under consideration in Australia. The Royal Commission was strongly critical of ASIC's use of that regime to resolve regulatory matters, particularly with larger financial institutions. ASIC largely did not accept enforceable undertakings in the period after the Royal Commission's report although there may now be signs of a return to a more balanced approach in that regard.

The Senate Economic References Committee's July 2024 Report – ASIC investigation and enforcement

I should also note this report, in an academic and not a judicial capacity, and, of course, in a balanced way.[46] I have several comments.

First, the passage of my professional career over some 35 odd years can be measured by the cycles of largely adverse views expressed about ASIC and its predecessors. Perhaps oddly, these have typically been put while, in parallel, ASIC pursues substantial enforcement actions, often with success, and its targets generally do not share its critics' perception of its lack of effectiveness. The Committee helpfully identifies earlier criticisms of ASIC's performance in Appendix 4 to its report. Of course, one should not mistake repetition of a theme for proof of its correctness. Second, it is plain that there is an expectation gap in respect of ASIC; unsurprisingly, it is blamed by consumers who suffer loss for not protecting them against misconduct; however often it points out that it cannot deliver a financial system free of a fraud and misconduct risk, and the expectation that it should do so often resurfaces in response to investor losses.

Third, the approach adopted in the Committee's report is not the only possible way in which to assess ASIC's performance; others approaches include that of the Financial Regulator Assessment Authority which, as the Committee recognises, found in 2022 that ASIC was "generally effective and capable in the areas reviewed", while also

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[44] For commentary, see K Manwaring & P F Hanrahan, "BEARing Responsibility for Cyber Security in Australian Financial Institutions: The Rising Tide of Directors' Personal Liability" (2019) 30 *J Banking and Finance Law and Practice*, 20-42.

[45] Section 93AA of the *ASIC Act* provides for ASIC to accept a written undertaken given by a person in connection with a matter in relation to which ASIC has a function or power under the *Corporations Act*. Section 93A of the *ASIC Act* allows ASIC to accept an enforceable undertaking from the responsible entity of a registered scheme in connection with the specified matters. The provision for enforceable undertakings corresponds to Australian Consumer Law s 218, which provided for enforceable undertakings in favour of the Australian Competition and Consumer Commission. For commentary, see M Nehme, "Enforceable undertakings in Australia and beyond" (2005) 18 *AJCL* 68; M Nehme, "Expansion of the powers of the Administrative Appeals Tribunal in relation to enforceable undertakings" (2007) 25 *C&SLJ 116*; M Nehme, "Enforceable undertakings and the court system" (2008) 26 *C&SLJ* 147; V Comino, "The GFC and Beyond – How do we deal with corporate misconduct" (2018) *JBL* 15. ASIC RG 69 sets out ASIC's policy in relation to accepting enforceable undertakings.

[46] I have here drawn on my paper, "Comments on Assistant Professor Varzaly's paper - Issues in enforcement", Monash University, 23 July 2024.

making several recommendations for improvement; and the empirical studies of enforcement actions undertaken by Assistant Professor Varzaly and in much of Emeritus Professor Ramsay's work. Fourth, there is reason to be cautious of a case study methodology and the risk of hindsight; the Committee's report discusses, for example, ASIC's response to the Courtenay House matter, but Ponzi schemes are typically plain with hindsight, and the report may give too little weight to the real difficulty of identifying which matters warrant immediate regulatory action from the multitude of reports that ASIC receives and ASIC's efforts, including the use of technology to address that difficulty. Fifth, and in passing, it might seem a tad unfair to criticise ASIC for delays in judgments in civil proceedings, where it must take the litigation process as it finds it.

Sixth, so far as the Committee (or at least some of its members) supports a separation of ASIC's functions between a "companies regulator" and a "separate financial conduct authority", the width of ASIC's jurisdiction plainly gives rise to real regulatory challenges; but can we reasonably expect that two regulators with the same resources, likely greater administrative costs and real boundary issues would achieve a better result?

Seventh, there is force in several of the Government Senators' brief additional comments, which recognise the complexity of the issues; note the competing considerations that "ASIC's broad remit assists enforcement" and "some evidence suggested it leads to ASIC being spread too thin"; note the need for detail of any model to separate ASIC's several functions; and also note that dissatisfaction with ASIC's response to and information provided to complainants, combining with a "common misunderstanding that ASIC is a complaints handling body", create "a significant perception problem that ASIC must address to build confidence in its capabilities." No doubt, more could be said, but I have been conscious of the need for balance here and I also wished to spend some time highlighting the several other issues which I have addressed above.

Law reform – Quality of Advice Review and ALRC Report

The Government is also implementing some parts of the Quality of Advice Review report (December 2022). That report recommended an expansion of the scope of "personal advice" and a narrowing of the scope of "general advice", and recommended that the existing "best interests" and priority duties and associated provisions be replaced by a duty to give "good advice" (defined by reference to the concepts of "fit for purpose" and "good" in all the circumstances) which would apply to all forms of personal advice and a best interests duty, with no safe harbour provision, which would apply to advice given by financial planners and their equivalents. The Government's response (December 2023) did not adopt that recommendation and indicates that the Government proposes to retain the best interests and priority duties and remove the present "safe harbour", which may have the consequence of reinstating a wider "best interests" duty. Several recommendations made in the Quality of Advice Review, including as to the treatment of superannuation advice and simplification of provisions for ongoing fee renewals and statements of advice, will be implemented by the *Treasury Laws Amendment (2024) Measures No 1 Bill* 2024.

There are difficulties with the complexity of aspects of the *Corporations Act*, and particularly Ch 7 of the *Corporations Act* dealing with financial services and the associated Corporations Regulations and ASIC class orders and instruments, although one should approach any claim for a direct link between complexity and misconduct with scepticism. The ALRC has also made substantial recommendations for reform of

the regulatory regime in respect of financial services. The ALRC recommended, inter alia, the introduction of a new financial services law as a schedule to the *Corporations Act*, amendment of the definitions of "financial product" and "financial service" and the restructuring of provisions relating to consumer protection, financial advice and financial services providers. The ALRC proposed a restructuring of Ch 7 of the *Corporations Act* and associated regulations and statutory instruments into the Financial Services Law, a scoping order and rulebooks, one of which would deal with disclosure rules, another with financial advice rules and a third with licensing rules. Recommendation 38 of the ALRC Final Report recommends grouping and consolidating provisions relating to financial advice, including requirements as to general advice and the best interests and conflicted remuneration provisions which I noted below. Recommendation 39 relates to the grouping and consolidation of general regulatory obligations of financial services providers, including licensees' obligations, the efficiently, honestly and fairly obligation and provisions relating to licensees' obligations as to conflicted remuneration, Although the ALRC's terms of reference did not extend to the review of the existing policy settings of the *Corporations Act*, the amendments that it proposed, if introduced, would likely have a significant impact upon the statutory regime.