

Article

Dispute Resolution & Insolvency

Federal Court of Australia Provides Guidance on the Requirements for Licensees to Take Reasonable Steps

The Federal Court's Decision in *Australian Securities and Investments Commission (ASIC) v R M Capital Pty Ltd*

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In a decade old, conflicted remuneration case, on 29 February 2024, Jackson J handed down the decision in *Australian Securities and Investments Commission v R M Capital Pty Ltd* [2024] FCA 151. ASIC commenced this proceeding on 7 June 2019 against *R M Capital Pty Ltd* (**RM Capital**) and SMSF Club as the named defendants.

This case provides the first judicial guidance on the construction of the statutory requirements for licensees to take reasonable steps under section 963F of the *Corporations Act 2001 (Cth)* (**Act**) to ensure authorised representatives do not receive conflicted remuneration.

RM Capital held an AFSL that authorised it to provide financial product advice for classes of financial products that included superannuation, and to deal in superannuation financial products.

SMSF Club Pty Ltd (**SMSF Club**) was an authorised representative of RM Capital and carried on the business of providing financial product advice and accounting and administrative services for self-managed superannuation funds. Positive RealEstate Pty Ltd (**PRE**) provided property investment services, including education, advice, and property mentoring.

SMSF Club provided its paying clients with a suite of services known as the 'SMSF Club'. This involved advising clients about SMSFs and administering them for the clients. Clients who signed up for the programme were known as SMSF Club members. SMSF Club helped club members set up an SMSF, roll over existing superannuation funds to it, and make other investments through it. It was common ground that if a client established an SMSF with the SMSF Club's assistance, their interest in the SMSF was a financial product.



RM Capital knew about SMSF Club's activities in a general way at the time. SMSF Club provided advice, including financial product advice, to clients as RM Capital's authorised representative. However, RM Capital did not admit that the particular conduct of SMSF Club on which ASIC relies constituted financial product advice.

Relevantly, PRE and SMSF Club were parties to a referral agreement (**Referral Agreement**). The Referral Agreement included a term to the effect that PRE would pay SMSF Club a fee of \$5,000 (plus GST) each time a client of PRE used SMSF Club's services to establish a bare trust within an SMSF to purchase a property through PRE. During the relevant period, there were approximately 170 instances of SMSF Club receiving referral fees under the Referral Agreement. The fees were paid because SMSF Club's clients purchased properties through PRE.

The conduct spanned from December 2013 to July 2016, when conflicted remuneration was banned by the Future of Financial Advice reforms.

It was common ground that RM Capital knew of the Referral Agreement and the fees payable under it. It is also common ground that RM Capital approved, monitored, and endorsed the Referral Agreement.

The case

In the case heard by Jackson J, ASIC claimed that RM Capital did not discharge its obligation under section 963F of the Act and did not take reasonable steps to ensure its authorised representative, SMSF Club, did not receive conflicted remuneration.

ASIC claimed that to discharge its obligations under section

963F of the Act, RM Capital should have had in place a conflicts policy that explained and prohibited the acceptance of conflicted remuneration, procedures for RM Capital to approve (or withhold approval of) any agreements under which its representatives might have received conflicted remuneration and a compliance programme that addressed conflicted remuneration.

ASIC specifically alleged that the approval procedure should have been applied to the Referral Agreement. Further, to the extent that RM Capital took other steps, those steps were insufficient in RM Capital's circumstances to satisfy the requirement in section 963F of the Act.

RM Capital argued that it did take reasonable steps to ensure that its representatives did not accept conflicted remuneration. It is important to summarise these steps to understand the Court's approach to determining what *reasonable steps* must be taken within the meaning of section 963F of the Act.

RM Capital presented four arguments:

1. First, RM Capital only reviewed and allowed authorised representatives to provide financial advice relating to products on its approved products list. This included a conflicted remuneration ban.
2. Second, RM Capital only appointed 'apparently appropriate' persons as authorised representatives through its Representative and Human Resources Policy. This ensured its authorised representatives had industry knowledge. RM Capital submitted that the conflicted remuneration ban was well-known, implying that if authorised representatives had industry knowledge, then it was likely that they would be aware of the conflicted remuneration ban.
3. Third, RM Capital periodically audited its authorised representatives and monitored remuneration by having remuneration payments made to RM Capital.
4. Fourth, RM Capital had a requirement for ongoing training and education by representatives, which included specific training and education on the future of financial advice reforms and the conflicted remuneration ban.

Findings by the Court

Although the construction of section 963F of the Act has not been judicially considered, the Court observed that there have been contested cases concerning section 961L of the Act. This section requires financial services licensees to take reasonable steps to ensure that representatives of the licensee comply with the best interests obligations in Part 7.7A Division 2.

ASIC and RM Capital agreed that the principles stated in those cases were applicable to the equivalently worded obligation in section 963F of the Act.

In addition to the above, Jackson J added a number of statements of principle relevant to what an obligation to "*take reasonable steps*" requires (see [68] to [86]). In summary, these included that:

1. Section 963F is not expressed as an obligation to take *all* reasonable steps to ensure that representatives do not accept conflicted remuneration. Section 963F leaves the question of precisely what to do to the licensee, provided that what is done is objectively reasonable. By the same token, a licensee will not escape a finding of breach of the section merely by pointing to one or two reasonable steps that it did take.
2. What constitutes reasonable steps to ensure that representatives do not accept conflicted remuneration will be a question of fact that depends on all the circumstances of the businesses and the activities carried on by the financial services licensee and its representatives.
3. Consistent with the approach the law invariably takes to inquiries of this kind, Jackson K considered that the question must be answered objectively and not by reference to what the licensee thinks is reasonable.
4. The objective assessment is made on the assumption that the financial services licensee has a correct understanding of the law.
5. The reasonableness of a given step must be assessed in all the relevant circumstances of the licensee in question. Considerations such as the degree of difficulty and practicability of any given steps, as well as the costs associated with them, may be relevant.
6. By the same token, Jackson J emphasised that the focus of the inquiry must always be on whether the steps that were taken in their totality were reasonable. That must be assessed having regard to the importance of the goal of preventing acceptance of conflicted remuneration and having regard to the circumstances of the case. This means that the steps that result in significant cost, inconvenience or difficulty to a licensee may still be reasonable ones to ensure that representatives do not accept conflicted remuneration.

Considering the above, ultimately, the Court found that during the relevant period, the steps that RM Capital took to ensure

that its authorised representatives did not accept conflicted remuneration fell short of the reasonable steps that section 963F of the Act required of a financial services licensee in RM Capital's circumstances.

Specifically, Jackson J found that, at a minimum, a financial services licensee in RM Capital's circumstances should have [at 343]:

1. formally adopted a clear written policy prohibiting the acceptance of conflicted remuneration;
2. informed new representatives (individuals and corporations) of that policy and its contents at induction or training sessions;
3. adopted written procedures to check whether any newly proposed products constituted conflicted remuneration under which promotion of the products offered monetary or soft dollar benefits to representatives. If so, RM Capital should have ascertained the details of those arrangements;
4. if there was room for reasonable doubt about whether any such arrangements constituted conflicted remuneration, obtained legal advice on the subject;
5. if it had determined that the arrangement did involve conflicted remuneration, refused to authorise the promotion of or advice in relation to the product until the aspect of the arrangement that involved conflicted remuneration was removed;
6. documented and implemented a training program giving representatives at least annual reminders of the existence and content of the prohibition on conflicted remuneration and RM Capital's policy on the subject, preferably with examples; and
7. annually conducted audits of a random selection of client files, along with annual checks as to what benefits, if any, representatives had received from the promoters of financial products, with any benefits of concern to be further investigated.

Concluding remarks

Although this case provides the first judicial guidance on the construction of the statutory requirements for licensees to take reasonable steps under section 963F, the principles identified are relevant and applicable to other provisions of the Act which require licensees to take "reasonable steps".

This case also demonstrates the importance of implementing adequate procedures to assess new products and identify arrangements that promote benefits to representatives that may result in conflicted remuneration. If there is any doubt about whether the arrangements constitute conflicted remuneration, be cautious and obtain legal advice.



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