



Michael Vrisakis Hi everyone. I'm Michael Vrisakis, a Partner in the Herbert Smith Freehills Financial Services Team. Welcome to our podcast series called the FSR GPS. This series focuses on topical and emerging issues in financial services regulation which we think are the most strategic and important issues for our clients. Feel free to suggest topics you would like us to cover in the future but for now, we hope you enjoy today's episode.

Abby Sutherland Hi, I'm Abby Sutherland, a solicitor in our Financial Services Team at HSF. I am joined by partners Michael Vrisakis and Andrew Eastwood, who each specialise in financial services. Thank you both for joining me today.

Andrew Eastwood Hi Abby, good to be with you.

Michael Vrisakis Hi everyone, yeah, it's great to be here.

Abby Sutherland Today, we thought we would have a chat about the recent judgment in *ASIC v R M Capital*, in which the Federal Court determined that the financial services licensee, RM Capital, failed to take reasonable steps to ensure its authorised representative, the SMSF Club, did not receive conflicted remuneration in breach of section 963F of the Corporations Act.

This is the first time a Court has considered the construction of section 963F, so we thought it would be useful to discuss what Justice Jackson said about what that section requires and consider whether the decision has any broader impacts.

First, by way of background, it is worth mentioning that the SMSF Club was authorised under RM Capital's licence to provide financial product advice about self-managed superannuation funds to retail clients. One of the key facts in the case was that RM Capital was aware of – and approved, monitored and endorsed – a referral agreement between the Club and another company that provided for the payment of certain referral fees to the Club, which were potentially conflicted remuneration (although RM Capital denied that they were).



Michael, to kick us off, what do you think are the key points of interest in this case?

Michael Vrisakis

Well, thanks Abby. Well, I mean, I guess as a starting point, the judgment clearly sheds light on both ASIC's and the Court's view as to what steps the licensee should have taken to meet the obligation in 963F.

ASIC argued that RM Capital should have had a conflicts policy that explained and prohibited the acceptance of conflicted remuneration; as well as procedures to review and approve agreements under which its representatives might have received conflicted remuneration; and a compliance program that involved appropriate training of representatives and monitoring of their compliance.

Justice Jackson accepted this. His Honour also held that a licensee in RM Capital's circumstances – which included knowledge of matters that gave rise to a risk that the SMSF Club was accepting conflicted remuneration, and this is a really interesting point – would have, and should have, obtained legal advice on whether the Referral Agreement involved conflicted remuneration. Now on one view, 'conflicted remuneration' is a quite technical area so you can see the validity of that statement by Justice Jackson in terms of the obtained legal advice.

What is interesting is that His Honour said that the requirement to 'take reasonable steps' does not require the licensee to take every reasonable step that could have been taken, and just pausing at that juncture, that seems very logical. Rather, the question of precisely what to do rests with the licensee, provided that, and I think Andrew is going to say something about that a little bit later, provided that what is done is objectively reasonable. And one can understand, again, the validity of that point. It can't be just something that is objective.

But, his Honour also stated that what is objectively reasonable depends on relevant circumstances, and I am going to say a bit about that actually, a little later, but that includes the licensee's knowledge and the known characteristics of the relevant representative.

So, you can see there's a real contextual and factual background to and lens through which you have to view those reasonable steps obligations. So in this case, the reasonable steps set out by Justice Jackson were directly impacted by the fact that RM Capital were aware of, but also approved/endorsed, the relevant referral agreement.



Abby Sutherland

Thanks Michael. That seems consistent, I think, with a trend we have been seeing in other cases, do you think?

Michael Vrisakis

Yes, no absolutely, it was a really logical and useful judgment. It was stepped out with a high degree of logic and it provides a lot of valuable illumination. But the point, and this point is relevant to 963F in particular, and other Chapter 7 obligations that require licensees to “take reasonable steps”, there are a number of those, for example, the obligation in section 961L of the Corporations Act, which requires licensees to take reasonable steps to ensure that representatives comply with the best interests duty and other personal advice obligations.

So, for example, in *ASIC v AMP*, the Court said, in relation to 961L, that, if the licensee is aware of the risk of non-compliance by a specific representative, the relevant steps are likely to be specific to that representative.

There’s an earlier case in the Federal Court that emphasised that breaching the reasonable steps obligation can occur independently of an actual contravention by the relevant representative. So, in that sense, they are, whilst they are dependent, they are not totally inter-dependent. So it also underscores the importance of the review of representatives’ conduct being comprehensive and timely. The Court did tacitly acknowledge that detectability of misconduct can be a legitimising factor i.e. how detectable is the misconduct.

The point is that the concept of “reasonable steps” is quite malleable, and it can depend on the circumstances of the licensee, the relevant representatives and other factors, including the nature of the financial service or financial product being distributed and the target client base not surprisingly.

This is also relevant to other obligations, such as the general obligation to take reasonable steps to ensure representatives comply with financial services law and as well as the obligation in the DDO context to take reasonable steps to ensure retail product distribution is consistent with the relevant target market determination.

So it is also important to mark this decision along the spectrum of different formulations that exist from a legal perspective, and you will see a number of those different formulations used in the licensee obligations, in the Corporations Act. So you’ve got reasonable steps, all reasonable steps,



necessary steps – each of which impose different, distinguishable legal and practical tests.

Abby Sutherland Thanks Michael. Andrew, do you think the case changes what licensees need to do to meet 'reasonable steps' obligations like the one in section 963F of the Corporations Act? Is it a significant change, do you think?

Andrew Eastwood Abby, I don't think the case involves a significant change – but it does provide some helpful clarification, of course, subject to the important point that Michael has already made about the concept of reasonable steps being malleable.

In terms of the helpful guidance, I mean, in particular, Justice Jackson makes some general comments in respect of what is required in order to meet an obligation, to take steps to ensure something is not done. His Honour suggested that an organisation with that kind of role should at least 'state clearly its position on the matter; communicate that position to new recruits; not give its authorisation to the promotion of or advice in relation to a product without checking that the product does not involve conflicted remuneration; follow through if the check gives cause for concern; periodically remind representatives about the existence and content of the prohibition; and then check to see whether it is being breached' (at [345]).

And it is likely that many of those steps will also be relevant to a licensees' ability to meet other reasonable steps obligations.

Justice Jackson also made the point that the degree of difficulty and practicality of any given steps, and their costs, are relevant considerations in working out what is reasonable. But there's a limit to how far you can take that. His Honour said that the importance of the goal that section 963F seeks to achieve (of preventing the acceptance of conflicted remuneration) and its focus on protecting retail clients, means that steps that result in significant cost, inconvenience or difficulty to a licensee may still be reasonable ones. So, it is not going to a complete answer for a licensee to say oh, this particular step would have been expensive for us to undertake.



Abby Sutherland Yeah, I think that's right, thanks Andrew. Michael, what do you think about the interaction between obligations such as section 963F and the 'efficiently, honestly and fairly' obligation in section 912A(1)(a)?

Michael Vrisakis That's a good question, Abby and I think it's worth pointing out that, there is a difference in terms of the standard in conduct because whilst the obligation to take reasonable steps to ensure representatives do not accept conflicted remuneration is a serious one, which, as Andrew has mentioned, may in some circumstances require 'inconvenient' steps to be taken, it does involve a lower standard than the 'efficiently, honestly and fairly' obligation.

That obligation, to act 'efficiently, honestly and fairly' in the provision of financial service under section 912A(1)(a) of the Corporations Act uses that higher formulation requiring a licensee to "do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly" (emphasis added). So, all things necessary, just stating that emphasis, whilst it has been held that the EHF obligation does not require absolute perfection, it is clearly a more onerous standard – it is the most onerous of that spectrum of obligations that I mentioned earlier around reasonable steps vs necessary steps.

I think when you look at these types of obligations and put them together, it is conceivable that a licensee could breach both the obligation in s 963F, that specific obligation in relation to conflicted remuneration, but also the EHF obligation, for example, where they fail to put in place reasonable policies and procedures to prevent representatives accepting conflicted remuneration. So often ASIC will assert breaches of multiple provisions of the Corporations Act as we know including the omnipresent misleading and deceptive conduct but, more specifically, from other more comparable cases that we have seen, the Courts have been interpreting the EHF obligation as a forward-looking provision which requires licensee to take steps to achieve compliance before any specific instance of non-compliance has arisen.

Abby Sutherland Thanks Michael. Andrew, in terms of evidentiary requirements, what do licensees need to do to establish they have taken reasonable steps?



Andrew Eastwood

Thanks Abby. Yes, I think this point about evidence is an important lesson from the RM Capital case. I'll mention a few examples of why I say that.

As part of its asserted reasonable steps as part of its defence, RM Capital sought to rely on the fact that it had a stringent policy that its authorised representatives had to undertake a certain number of hours of training each year. Now that's good, so far as it goes but when the actual evidence was considered, there was no record or register of who actually attended training. Further, when the content of the training was analysed, it wasn't apparent that the training actually covered the topic of conflicted remuneration in any detail.

Another example is monitoring. RM Capital sought to rely, as part of its reasonable steps, on it having a practice of auditing the records of authorised representatives periodically. Again, that would be an important aspect of reasonable steps but again, the evidence didn't really support the contention. As to the content of audits performed, the evidence didn't establish that the audits included checking whether conflicted remuneration was received. And in the case of SMSF Club, the evidence showed that, over the relevant period, only a very small number of reviews or audits of the Club's files were undertaken.

I can give you other examples but the key point is that, if a licensee finds itself the subject of an ASIC investigation or (worse still) a Court proceeding, it is not going to be enough to assert that the licensee has policies and procedures, and conducts audits and reviews, and conducts training and the like. The licensee is actually going to have to prove, by admissible evidence (preferably via documents) of what has occurred.

Abby Sutherland

Thanks Andrew. Michael, do you think there are different thresholds for assessing when a licensee should report a breach of a more technical provision like section 963F and general conduct obligations like the requirement to take reasonable steps to ensure representatives comply with s912A? Do you think there is a difference in how licensees should approach the analysis in these situations?

Michael Vrisakis

Thanks Abby. I think that the relevant issue here, the most relevant issue is that the case makes it really clear that reasonable steps and the reasonable steps yardstick that you need to apply, is going to depend on the factual setting and I think by the same logic, they undoubtedly will depend on the statutory context. So, to your earlier point, it may well



depend on the severity of the provision, the offence and the requirements that are specified specifically in the statute. But broadly speaking all these obligations that you mentioned are standards of conduct and the legislature has chosen reasonableness as that statutory yardstick. It should follow logically that what constitutes reasonable steps will be determined by this yardstick of reasonableness and reasonableness, I mean there's a malleability factor which we've talked about. But I think there is one really important additional point to make and that is that as you see in areas like negligence of what's reasonable, the yardstick of reasonableness in this context and the statutory context, undoubtedly can evolve and it will evolve through the medium of community expectations which is a real kind of catch cry of the Courts and obviously stem from the Royal Commission. But also other important factors such as improvements in technology may well affect that standard of reasonableness and, of course, there's always what Courts find in future comparable cases, as the Courts give guidance that can then in turn affect the concept of reasonableness and how licensees need to interpret it going forward.

Abby Sutherland Definitely, and for the last word, Andrew any thoughts on this standard of 'reasonableness'?

Andrew Eastwood Well, Abby, reasonableness is somewhat in the eyes of the beholder! It is important for licensees to appreciate that the test under 963F (and similar provisions) is objective – so it isn't answered by what the licensee thinks is reasonable. It isn't a gold-plated standard, or a standard of perfection. But at the same time, as we've discussed, just because particular steps may be difficult or costly to the licensee doesn't mean that they aren't "reasonable".

I think the unfortunate aspect of any reasonableness standard in the law is that there aren't black and white lines; the assessment in any particular case will be fact-dependent. But, as we have discussed, this decision in RM Capital case does give us some helpful guidance as to the kinds of steps that ASIC and a Court are likely to look for.

Abby Sutherland Thank you very much, Andrew and Michael for your insights, and thank you to the listeners for joining us today.



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