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EVERYTHING YOU NEED TO KNOW ABOUT BEST INTERESTS DUTY

A short, sharp guide to complying with the best interests duty

Claire Wivell Plater and Sonia Cruz

There are four things that you need to do after 1 July 2013 when providing personal advice to retail clients - in addition to the disclosure requirements. The four things include (note: the italicised items are new):

- *Act in the best interests of the client,*
- Provide appropriate advice,
- Warn the client if the advice is based on incomplete or inadequate information, and
- *Prioritise the client's interests.*

Best interests of the client

If you do the following, in theory, you'll satisfy the duty to act in the best interests of your retail clients when you provide personal advice:

1. Identify client's circumstances - Determine the client's objectives, financial situation and needs. Initially, base this on the information the client provides. Then ask as many questions as you need to really get to the nub of what the client wants (and needs).

Here are some tips:

- Use a fact-find/needs analysis so you don't miss anything
- If the client's instructions are unclear, or seem inconsistent with their circumstances, then keep digging until you are clear
- Think about whether the client's request for advice was triggered by anything, e.g. receipt of an inheritance or being made redundant. What other information might be relevant?

2. Identify subject matter – Work out the scope of the advice the client requires.

It could be a goal the client wants to achieve or a strategy for reaching the goal. It could be a recommendation about a financial product or a class of products.

It could be a single issue, a number of issues or holistic advice. Scoping the advice carefully helps show you understand the client's needs.

The scope could be explicit, such as a request for advice on nominating beneficiaries for superannuation. It might be implicit, such as when a client asks for advice on insurance when starting a new business.

Scoping the advice carefully helps show you understand the client's needs. Use your knowledge about financial strategies and products

The quote

The net benefits from the new product must be better than the existing product.

and your judgement to ensure the scope of the advice is consistent with the client's circumstances and the advice they've asked for. Your view of the scope may change as you obtain more information. Look at:

- What the client has told you,
- Why they've sought advice,
- The outcomes they want to achieve, and
- How much they are willing to pay for the advice (if they can't pay an appropriate fee, you'll need to clearly limit the scope of the advice to what they can afford).

Tell the client what advice you think they are seeking - to test if you are on the right track.

3. Identify relevant circumstances - Work out which of the client's objectives, financial situation and needs are relevant to the advice they have asked for. Use your judgement. Keep asking for information until you have enough.

If you discover that the client needs different advice to what they have asked for or what you have already agreed, discuss this with the client to see if they want advice on a different topic.

4. What if the information is incomplete - If it's reasonably apparent that the information you have is incomplete or inaccurate, make reasonable enquiries to obtain complete and accurate information.

Something will be reasonably apparent if it would be apparent to a person with reasonable expertise in the type of advice that the client is seeking, if they were exercising care and objectively assessing the information provided by the client.

5. Check your expertise - Assess whether you have the necessary expertise required to provide the advice requested. Look at:

- Any limit on your authorisation,
- Your professional qualifications and training, and
- Your knowledge and skills.

If you don't have the expertise, tell the client you can't advise them. Refer them to someone who does.

6. Research products - If it's reasonable to recommend a financial product, then investigate and assess the products that might achieve the client's goals.

If you use research reports, be sure they are provided by reputable researchers. You don't have to investigate every product available, but you do have to investigate the products you recommend.

When recommending that a client switch products, research both the existing and new products to see which one better meets the client's needs. Comparing the existing and recommended products will help prepare the information needed for your SoA.

You might need to look at products that are not on your APL, for e.g. where:

- The client's existing products might meet their needs, but are not on your APL,
- Your APL is restricted to one class of product, and other products would better meet the client's needs, or
- The client asks you to consider a product that's not on your APL.

Things to think about....

Does your licensee allow you to go outside the APL? If not, you might have to decline giving advice.

PI insurance generally doesn't cover advice on products that are not on the APL. Do you need to ask your insurer to remove this exclusion? Will they agree?

7. Base judgements on the client's circumstances - Base all your judgements on the objectives, financial situation and needs of the client.

8. Anything else - Take any other step which is reasonably in the client's best interests at the time the advice is provided. This might include:

- Telling the client what advice you are and are not providing,
- Providing related strategic recommendations when you recommend a product,
- Telling the client when they need to review any decision they make, e.g. if their circumstances change, at intervals or after a set period, and
- Offering to advise on other key issues that you think they need advice on (or referring the client to someone who can).

Taking these eight steps puts you in the 'safe harbour'. In theory, you'll have acted in the client's best interests if you do all these things. Why do we say 'in theory'? Because the test is objective. Your advice must still be appropriate for the client. So on we go.

Appropriate advice

There are two tests for whether advice is appropriate:

- It's fit for its purpose, and
- It will put the client in a better position.

Fitness for purpose

Advice will be fit for its purpose if following it is likely to achieve the client's goals.

Better position

If a reasonable adviser would believe that the client is likely to be in a better position if they follow the advice, then the advice will be appropriate – even if the advice is to do nothing.

This is assessed at the time the advice is given – not with the benefit of hindsight.

You can look at:

- The position the client would have been in if they didn't follow the advice,

Example

If advice to invest in Australian equities is appropriate for a client, a fall in value due to a downturn in the market is irrelevant to whether the best interest's duty has been met.

- The facts that you had, or should have had, if you'd made sufficient enquiries,
- The subject matter of the advice sought by the client, and
- The client's objectives, financial situation and needs.

Clients don't only seek advice to improve their financial position. There are many ways a client can be better off. They can also be better off if:

- Their understanding of their financial position is improved,
- Their financial position is realigned to their risk tolerance – even if this lowers their return,
- They are clear that they don't need to make any changes to their financial arrangements,
- They are confident enough about their financial position to spend or donate their money – or they realise they need to save more if they are to have enough to live on in retirement, or
- They are provided with services that they value, e.g. online access to reports.

However the benefit they get from following your advice must be more than trivial.

Some things to avoid

One-size-fits-all processes

Advice models that lead to one-size-fits-all advice are unlikely to ensure that advisers will act in the client's best interests. Fight back if your employer or licensee requires this. Remember, it's your neck on the line now.

Switching

Advice to switch will only be appropriate if it's reasonable to conclude that the net benefits likely to result from the new product are better than the existing product. In short, the net benefits from the new product must be better than the existing product.

Overall cost savings can override the loss of other benefits – provided you take into account switching fees and adviser's fees that are payable only if the switch is made.

Tax

If material tax implications arise out of your advice that you don't have the expertise to advise on, recommend that the client seek tax advice before implementing your recommendations.

You can base your advice on tax advice given by someone else. But be clear that you're assuming the advice is correct, not endorsing it. Otherwise you could be liable for the tax advice!

Some things to do

Show how you have acted in the client's best interests in your SoA. The best way to do this is to explain how you believe the advice will put the client in a better position.

This will also help you to demonstrate a reasonable basis for your advice.

Incomplete/inaccurate info

In practice, clients are often reluctant to provide sensitive or personal information. If it's reasonably apparent that the information provided by the client is incomplete or inaccurate:

- Make reasonable inquiries to obtain complete and accurate information, and
- If the information still appears to be incomplete or inaccurate, warn the client that your advice is (or may) be based on incomplete or inaccurate information and before acting on it, they should consider whether it is appropriate for them.
- Give this warning at the same time and in the same way as your advice. If the advice is provided in an SoA, include it in the SoA.

Prioritise the client's interests

Place the client's interests ahead of your own (and the interests of anyone associated with you or who has authorised you to provide the advice – including your employer or AFS licensee).

This 'conflicts priority rule' means it's no longer enough to disclose a conflict or get the client to consent to it. Disclosing or getting consent to a conflict just doesn't cut it anymore. You just have to avoid it.

In practice, this means you can't further yours or anyone else's interests when providing advice (other than the client). It's an objective test. If a reasonable adviser without a conflict of interest wouldn't provide the advice, it will be conflicted.

You will need to recommend non-product solutions where appropriate for the client, even if the client is less likely to need financial advice going forward, e.g. debt reduction, social security.

If you have a conflict and you can't prioritise the client's interests, don't provide any advice.

Things you can do include:

- Recommend a client invest in a product issued by a related party,
- Accept remuneration from product providers – at least for risk insurance and grandfathered commissions.

But the things you can't do include:

- Don't recommend a product or service of a related party to create extra revenue for yourself, your licensee or the related party – unless you can demonstrate an additional benefit for the client,

> **Example**
> A client needs additional life cover of $100,000. Don't recommend the client cancel the existing policy and take out a new policy rather than apply for an increase in the existing cover just to obtain additional commission if the terms and premium of the existing and new policies are the same or comparable.

- If your APL is limited to products issued by a related party, don't recommend a product unless a reasonable advice provider would be satisfied that the product is in the client's interests, rather than another product with similar features and costs.

> **Example**
> Advisers employed by banks should not recommend in-house products if their performance is significantly worse than similar products.

- Don't over-service the client to generate more revenue. Your services must be commensurate with clients' needs and budget.

Example
Don't recommend a complex strategy (e.g. an SMSF) if the client can't afford or is unlikely to seek the ongoing advice needed to maintain the strategy.

Warning – If your performance is measured on the basis of the remuneration you bring in, not only could you be receiving conflicted remuneration, but you could be failing to prioritise the client's interests. Remember, it's your responsibility now. Is it worth it?

It's all about quality advice

At the end of the day, you should be seeking to achieve good quality advice. Focusing on the following will help you to achieve this:

- Clearly define the scope of the advice,
- Investigate the client's relevant circumstances,
- Help the client set prioritised, specific and measurable goals and objectives,
- Consider all potential strategies and options that will meet the client's goals,
- Think about all the consequences of your advice, e.g. tax or social security implications, and
- Help the client to understand your advice and recommendations. **FS**