**HUGGINS LEGAL**

# LITIGATION AND REGULATORY RISK UPDATE

## EDITION 1 – 19 OCTOBER 2022

Welcome to the first edition of Litigation and Regulatory Risk Update – a newsletter for AFSL holders about developments in litigation risk (both in a Court and at AFCA) and regulatory risk.

### 1. What has happened?

The Federal Court has handed down its Decision in Australian Securities and Investments Commission v Dixon Advisory & Superannuation Services Ltd [2022] FCA 1105. The Decision is about a civil penalty.

### 2. What do I need to know about this?

2.1 Many provisions of the Corporations Act that apply to AFSL holders are civil penalty provisions – in particular, s961B (must act in the best interests of the client) and s961G (resulting advice must be appropriate to the client).

2.2 ASIC can apply to the Federal Court for a pecuniary penalty order (an order that a penalty is paid to the Commonwealth by an AFSL holder) where there is a breach of a civil penalty provision. The maximum penalty is currently $10.5M per contravention (it was previously $1M per contravention). Defending this type of application requires an AFSL holder to participate in Federal Court litigation (thereby incurring substantial costs) and to take on the risk of having adverse costs orders made against it.

2.3 The Decision is about an AFSL holder failing to comply with s961B and/or 961G with respect to 4 higher risk financial products that were acquired by 8 clients. The extraordinary level of risk posed by the civil penalty provisions can be seen by what happened in the case of one of these clients. On 3 occasions this client was advised to buy a total of 4 financial products that had a combined worth of around $160K and on 2 occasions the client was advised to retain these products. The Court held that on each occasion (the last occasion was after the potential $10.5M penalty applied) there had been a contravention of s961B and/or s961G and decided that the penalty with respect to this client was $1.085M. Of this amount, $695,000 was imposed with respect to the last occasion (advice to retain financial products). What this means is that 5 instances of poor advice concerning about $160K worth of assets (2 of which involved advice to retain products) that essentially involved the same issue generated a penalty of $1.085M. If all the breaches had occurred today (because the potential penalty is now $10.5M per breach) the penalty would have been much higher.

2.4 The Court imposed a total penalty of $10.380M and reduced the penalty by 30% (to take account of the AFSL's holder's cooperation) to $7.2M. The AFSL holder also had to pay $800,000 to ASIC for its legal costs.

## 3. What should I do?

3.1 The civil penalty provisions are a very significant (and potentially catastrophic) source of risk for AFSL holders in that:

(1) ASIC is increasingly relying on these provisions – commencing civil penalty proceedings is something that ASIC has shown that it is willing to do;

(2) very substantial penalties have actually been imposed in circumstances where (as was the case here) multiple (very substantial) penalties have been imposed for conduct which involves providing the same advice to the same client on more than 1 occasion and/or providing the same advice to multiple clients – what is really one failure can been seen as multiple contraventions which in turn leads to the possibility that an extraordinarily high penalty can be imposed ; and

(3) civil penalty proceedings have to be defended in the Federal Court - this is expensive. Defending proceedings and losing will cause a higher penalty to be imposed (because there will be no *cooperation* discount) and an order to pay ASIC's costs will be made.

3.2 In this context, I suggest the following things need to be done:

(1) be generally wary about circumstances where high risk financial products are recommended to clients – both in terms of the client's risk profile (that is, whether a product can be said to be appropriate for a client having regard to the client's risk profile) and in terms of asset allocation (the overall exposure within a client's portfolio to higher risk asset classes);

(2) avoid circumstances where it can be said that a recommendation was made because of some connection between the issuer of the financial product and the adviser (allegations about poor advice that also involve allegations about conflicts of interest are much harder to defend);

(3) avoid making recommendations to the effect that a SMSF should acquire a high risk financial product – these types of allegations are very difficult to defend;

(4) accept that when clients have lost money there is a significant risk that complaints will be made to ASIC. Situations where clients have suffered loss need to be proactively managed (that is, not waiting for clients to complain before action is taken to manage the situation) so as to prevent them from becoming a regulatory issue where civil penalty proceedings could be a potential outcome;

(5) avoid situations where multiple clients are placed into the same high risk financial product. These types of situations raise substantial litigation risk (particularly at AFCA) but raise very substantial risk with respect to civil penalty proceedings (because what is essentially 1 failure can be viewed as multiple breaches each of which can attract a very substantial penalty); and

(6) procedures must be put in place so as to ensure that all complaints made to advisers are actually reported to Compliance – when one client starts complaining others, who are in the same position, will follow – if the issue is not properly managed when the first complaint is made it can turn into a much more significant issue.

If you would like to discuss any of the issues raised in this Update please, of course, don't hesitate to contact me.

Regards

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