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Conflict: part of life, part of business

CLERP 9 amendments have put the spotlight on conflicts of interest, and as PAULA ZAMMIT reports, planners must have systems in place to manage them.

You might ask, why should I worry about conflicts? After all, conflicts are a natural part of life, right? But the question you need to be able to answer is: do you have the systems in place to manage your business conflicts in compliance with the latest amendments to the Corporations Act?

First of all, you must understand the meaning of 'conflict' when referring to your business practice. And I'm not talking about the conflict you had this morning with your client regarding the rugby game on the weekend!

While you may not have all of your systems and procedures documented in order to comply with the legislative requirements, the 'conflicts' amendments should not cause any real significant change to your actual business practice.

The amendments are a result of CLERP 9. The amendment to the Act can be found at the new subsection 912A(1)(a)(aa) and you have until January 1, 2005 to transition. Subsection 912A(1)(a)(aa) of the Act requires that you must have "in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensees or a representative of the licensee in the provision of financial services as part of the financial services business of the licensee or the representative".

This means that you need to have adequate arrangements in place that identify all conflict of interest situations. Such arrangements are not limited only to your documented processes but to your actual everyday business practices – specifically, the way in which you conduct your business will need to 'control' and 'disclose' the conflict and, in some cases, 'avoid' the conflict.

Now to take a step back and understand where the conflicts amendments come from and why complying should not cause you a headache.

To put it simply, the new subsection 912A(1)(a)(aa) appears to be nothing more than an attempt to codify the already existing common law principal of fiduciary duties. As you will appreciate, licensees and their representatives owe fiduciary duties to their clients as a result of their fiduciary relationship.

A fiduciary relationship exists as a result of trust and confidence, that is, where one person puts trust into another. Fiduciary relationships also exist for example, between solicitors and clients, trustees and beneficiaries, directors and companies and employees and employers. In part, it is a fiduciary relationship that drives the establishment of a 'profession'.

The common law requires that the person who owes the fiduciary duty must act with honesty, integrity and fairness, must always act in the interests of the person to whom the duty is owed and has a duty to not act in conflict of that person's interests.

The common law duty not to act in conflict can be broken down into two parts: the conflict rule and the profit rule. The object of the first rule is to preclude the fiduciary from being swayed by consideration of personal interest. The objective of the latter rule is to preclude the fiduciary from actually misusing his position for his personal advantage.

In essence, the amendments being a codification of the common law should not have brought about any fundamental change to your business practice. You should already be practising in such a manner that fits the amendments because in practice, you are already bound by the common law. The only real change the amendments may have brought about to your business is the requirement that by January 1, 2005, you have documented the procedures that you have in place that identifies all conflict of interest situations and how you manage those situations.

The Australian Securities and Investments Commission's (ASIC) proposal, 'Licensing: Managing Conflicts of Interest', issued in October 2003, is that management can be achieved through the three basic procedures: controlling conflicts; where appropriate, disclosing the conflicts; and in some cases, avoiding the conflicts all together.

> "You need to have adequate arrangements in place that identify all conflict of interest situations."

Already, there is significant debate as to what constitutes a conflict of interest situation. For example, if you recommend a particular financial product to a client that is no different to three other financial products, but the benefit to you in recommending that particular product over the other three is that you receive an overseas holiday, then is there a true conflict of interest? In this situation, particularly if it can be shown that the financial product in which the client invested is no different to the other three products, then is disclosure enough to satisfy the law?

And what happens in the situation where you reach your quota of investing clients into a particular product? Is it enough only to disclose the potential benefit, or should you have disclosed the benefit to all clients? What if it is not an overseas holiday but an educational conference? What if you never had any intention of taking up the offer? Are these true conflict situations and how do you disclose these?

The key to what is or may be considered a conflict of interest turns not only on the "interest" component but also on the reason for providing the advice. What must be avoided is providing wrongful advice that is caused by an "interested" motive.

As you will appreciate, we lawyers have had to deal with this very issue from almost the beginning of our existence and I suspect that the requirement for us to manage our conflicts of interest came into play not long after the first account was sent to a client.

In our firm, we have processes and procedures in place to ensure that we identify, manage and deal with our conflicts of interest on a daily, if not hourly, basis. How else would our senior partners sleep at night unless they were confident that their junior solicitors were identifying and managing their conflicts of interest?

Our senior partners really are in no different a situation than Australian financial services licensees.

The object of the common law principle of the fiduciary duty, which is also ASIC's objective, is not to stop action being taken when such conflict circumstances arise, but to compel disclosure of certain types of actions to ensure that full and proper consent is given, even though a conflict of interest may exist.

So, if you think about it, at the end of the day, if you are already managing your business and applying best practice standards, then provided you have your documented systems in place by January 1, 2005, you should be fine.

If you are a representative, and you are confident that you can demonstrate that you have satisfied section 945A of the Act, which is more commonly referred to as the 'know your client rule', then that should mean you have always acted in the interests of your client and have not been swayed by your own personal interests.

Remember, if you are a representative of a licensee, the common law places individual responsibility upon you and therefore liability on you individually – so don't think it's all up to the licensee to work out how to comply.

If you are a licensee, you should be able to breathe easy because you should be confident that the monitoring and supervision practices and procedures you have in place already deal with conflicts.

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