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The dangers of ignoring client vulnerability

Jamie Munton and Paul Derham

Chances are you are reading this paper on an electronic device. You may have used the same device to video-chat with others, message your team and create or send documents—in the last hour. Navigating the device and its various software tools can be *complicated*—really complicated.

Financial products are also becoming more complicated, and this creates a new problem: vulnerable clients. The Commissioner of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission), Kenneth Hayne QC, considered that the complexity of financial services required by people to live in modern society put them at a disadvantage when dealing with financial service providers (Royal Commission *Final Report*, volume 1 p. 491).

Notably, the Commissioner considered this an issue not just for vulnerable clients, but also clients who because of their circumstances were in a more vulnerable situation (Royal Commission *Final Report*, volume 1 p. 89).

As professionals, we trade on being the most knowledgeable people in a room on a specific topic and sought out for our advice and assistance. This advice (be it personal or general) is normally required for people who do not fully understand our field or who are not able to conduct business without our guidance.

This reliance puts us in a position of power and trust. While this

power can provide great benefit to us and our clients, misuse either deliberately or negligently can have significant impacts on clients, us, our business and ability to practice. These impacts can be both professional and financial.

So, as regulated entities, we need to look carefully at how we need to treat vulnerable clients.

Where to look

To get a steer on what to do about vulnerable clients, there are a number of sources:

ASIC

The Australian Securities and Investments Commission (ASIC) has made it clear that licensees need to do something about vulnerable clients. In the *ASIC Corporate Plan 2020-2024*, the regulator noted that it is focusing enforcement activities on conduct that harms vulnerable consumers. There are plenty of examples, including ASIC:

- using its product intervention power to target providers of continuing credit contracts (Consultation Paper 330 *Using the product intervention power: Continuing credit contracts*)
- shifting its regulatory priorities in light of COVID-19 to protect “vulnerable consumers”.

FASEA

Vulnerable clients are also an issue in the financial planning context. Providers of personal advice to retail clients in relation to relevant financial products must comply with the Financial Adviser Standards

and Ethics Authority (FASEA) Code of Ethics (*Corporations Act 2001* (Corporations Act) section 921E).

It is the Australian financial services (AFS) licensee's responsibility to ensure that all advisers comply with the code (*Corporations Amendment (Professional Standards of Financial Advisers) Act 2017* section 921J and Corporations Act section 921K). The Code of Ethics requires advisers to:

- act with integrity and in the best interests of each of their clients (FASEA Code of Ethics Standard 2)
- not advise, refer or act in any other manner where they have a conflict of interest or duty (FASEA Code of Ethics Standard 3)
- provide to a client any advice or financial product recommendations that are in the client's best interest and appropriate to the client's individual circumstances (FASEA Code of Ethics Standard 5)
- be satisfied that the client understands the advice and the benefits, costs and risks of the financial products recommend (FASEA Code of Ethics Standard 5)
- consider the broader effects arising from the client acting on the advice, and actively consider the client's broader, long-term interests and likely future circumstances (FASEA Code of Ethics Standard 6).

Design and Distribution Obligations

The theme of vulnerability is embedded in the new Design and Distribution reforms enacted by the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019*. The requirement for product issuers to make a target market determination, necessitates the issuer considering the likely objectives, financial situation and needs of a retail client in the target market (*Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* (DDO & PIP Act) section 994B(8)).

Product issuers and distributors of a product for which a target market determination has been made are obligated to ensure that they take reasonable steps to ensure the product is reasonably likely to be distributed consistent with the target market determination (DDO & PIP Act section 994E(1)). ASIC in its draft Regulatory Guide 000 *Product design and distribution obligations* advises that it expects this to include provision of how a distributor would deal with vulnerable clients within the target market.

AFCA

In a media release of 27 May 2020, the Australian Financial Complaints Authority (AFCA) reported a spike in vulnerable-client related complaints due to COVID-19, and has released much guidance on the topic.

AFCA chair Helen Coonan, in a 2019 speech to the AFR Banking and Wealth Summit, said AFCA considered the timely and open treatment of complaints to financial services providers as a key focus area. Delays in responding to and dealing with complaints will be called

out. This is of particular concern regarding vulnerable clients who may not be as proactive in driving their complaint, requiring more active monitoring by financial service providers.

AFCA's *The AFCA Approach to joint facilities and family violence* report also raised a concern for financial services firms dealing with domestic or family violence situations to develop processes for ensuring the adequate protection of information about vulnerable clients. AFCA also noted that where two clients are interviewed together, vulnerable members of the partnership are unlikely to disclose accurate information in front of their abuser.

Who are vulnerable clients?

In order to define vulnerable clients for our Vulnerable Client Policy, we had to bolt together a number of different definitions. There is no single point of reference. Client vulnerability can be caused by many things, including age and levels of stress. This can be permanent or just a point-in-time concern. The Australian banking Association's *Banking Code of Practice* said that a vulnerable person can be someone:

- elderly or suffering an age-related impairment
- suffering any form of cognitive impairment
- suffering from elder or financial abuse
- experiencing family or domestic violence.

The *ASIC Corporate Plan 2019–23* said that a vulnerable consumer can be anyone:

- experiencing specific life events, including:
 - divorce
 - job loss
 - death of a close relative
 - accident or sudden illness
 - having a baby
- suffering from mental or other forms of serious illness
- suffering from any form of addiction
- experiencing any other personal or financial circumstances causing significant detriment.

The Royal Commission's *Final Report* (volume 1 p.89) said that vulnerability can also be indicated by factors, including clients:

- living in rural or remote areas
- whose first language is not English
- who are unable to readily produce standard identification documents.

Dealing with vulnerable clients

Having a vulnerable client does not always mean that you cannot provide services to them. Generally, when dealing with a vulnerable client, you should consider taking extra steps to ensure they are not disadvantaged.

According to FASEA's *Financial Planners and Advisers Code of Ethics 2019 Guidance*, these could include:

- allowing a longer time for the client to make a decision
- providing more education tools before allowing the client to trade
- encouraging the client to ask questions of the adviser



The quote

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- asking extra questions of the client to test the client's level of understanding of the recommendations being made, and the basis for making them
- ensuring as far as possible that the client feels equally free to reject the recommendation to reduce the risk that the client may be substituting trust in the adviser for rational decision-making
- recommending the client undertakes education tailored to their capacity to understand
- in personal advice situations:
 - encouraging the client to seek input from a trusted friend or family member with no conflicting interest in the outcome, and offering to meet and explain the recommendations to the family member
 - asking questions of the client to test their level of understanding of the recommendations being made, and the basis for making them
 - asking the client to explain back key elements of the advice to the adviser
 - presenting lower-risk options to the client in the advice to facilitate comparison and effective choice in the client's decision-making.
- Embed vulnerable client behaviours into your key risk indicators (KRIs). Your monitoring and supervision program should identify KRIs unique to your business. When the KRIs are triggered, your monitoring and supervision program should delve deeper into the representative behaviours connected with that KRI.
- Document every step and action taken.

Conflicts of interest and vulnerable clients

AFS licensees are required to manage conflicts of interest (Corporations Act section 912A(1)(aa)). Further, if you provide personal advice to a retail client, you must prioritise the interests of the client if a conflict exists (Corporations Act section 961J). When dealing with vulnerable clients, there may be other circumstances where a conflict may arise, including if:

- you are pressured to provide advice for a vulnerable client by an existing client
- you recognise that the client is vulnerable and proceed with the advice without taking the appropriate precautions
- you provide advice to a couple and you are concerned one of them is a vulnerable client.

Key take outs

As an AFS licence holder, it is important to:

- Show that you had concerns with the vulnerability of the client, and the steps you took to address this. This may mean refusing to provide your services to the client.
- Consider if simpler or lower-risk products would be more appropriate to the level of the client's understanding.
- Do not recommend products that require client control or intervention (e.g. self-managed superannuation funds (SMSFs)).
- If you are providing trading services, do not allow clients to trade using their SMSFs unless they can show a high degree of financial literacy.
- have a clear policy in place for how vulnerable clients are to be identified and assisted
- conduct training with staff on how to identify vulnerable clients, and the factors that may make a client vulnerable
- monitor and supervise representatives using KRIs that consider client vulnerability
- develop a clear process for identifying and servicing vulnerable clients, which may include refusing to provide certain services
- ensure when dealing with vulnerable clients that all file notes and process are documented. **FS**