FSC FINANCIAL SERVICES COUNCIL

4 June 2018

Mark Brimble
Acting Managing Director
Financial Adviser Standards and Ethics Authority
Sydney NSW 2000

BY EMAIL: Mark.brimble@fasea.gov.au / consultation@fasea.gov.au

Dear Mr. Brimble

RE: FASEA's CODE OF ETHICS FOR FINANCIAL ADVISERS - EXPOSURE DRAFT OF PROPOSED STANDARD

The Financial Services Council ("**FSC**") is the peak industry body representing financial services businesses in Australia. We welcome the opportunity to make a submission to the Financial Adviser Standards and Ethics Authority ("**FASEA**").

The FSC has over 100 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, licensed trustee companies and public trustees. The industry is responsible for investing more than $3 trillion on behalf of 14.8 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Should you wish to discuss this submission further please do not hesitate to contact me on (02) 9299 3022.

Yours sincerely

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FINANCIAL SERVICES COUNCIL – SUBMISSION ON CODE OF ETHICS

INTRODUCTORY COMMENTS

The FSC supports the development of an industry wide Code of Ethics ("**Code**") that applies to all financial advisers who are authorised to provide financial advice under the Act[1]. We believe that the Code, together with the reforms regarding education and ongoing training requirements, should greatly assist in enabling financial advisers to regain the trust and confidence of consumers. However, we would like to make the below comments regarding parts of the Code which we believe should be amended to provide financial advisers and Australian Financial Services Licensees ("**Licensees**") with more certainty regarding its application.

GENERAL COMMENTS ON THE PROPOSED STANDARD

While we appreciate that the Code, by its very nature, is a high level set of principles and core values, many of the standards appear to import a subjective test (see Standards 1, 3, 4, 5, 7, 8 and 11). If an analysis had to be undertaken for each possible breach of the Code of what may or may not have been in the consumer's mind at the time the advice is given, advisers would have very little certainty as to how to ensure compliance with the Code. This makes the Licensee's obligation to take reasonable steps to ensure their representatives' compliance with the Code even harder, given they are another step removed from the client. So far as possible, subjective tests should be replaced with objective ones. Where this is not possible, we suggest FASEA develop guidelines (including case studies) regarding the kinds of conduct that it considers will and will not breach the Code. In fact, we consider that industry would greatly benefit from guidance on each standard. This may be something that FASEA decides to undertake after the completion of the drafting of the Code, in consultation with industry (perhaps in working groups or roundtables). Our members would welcome the opportunity to participate in such activity. See below regarding specific guidance sought.

We consider that the Code ought be consistent with the advisers' and Licensees' legal obligations; and that regulators and Monitoring Bodies[2] work together in enforcing the law and the Code respectively, otherwise the Code may have the effect of slowing down the investigation and enforcement of the law, thereby slowing down any necessary remediation of customers.

Finally, the Exposure Draft makes reference to "*conduct review processes*". However, this term is not referred to in the Act. We seek clarification from FASEA regarding this reference.

SPECIFIC FEEDBACK SOUGHT

1. *How the Code addresses the consumer detriments that have arisen in financial advice, particularly Standard 2, which is intended to ensure that the advice (or referral or other service) that a consumer gets from an Adviser does not produce inappropriate personal advantage to the Adviser.*
   Additionally:

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[1] All references to the Act is to the *Corporations Act 2001*, as amended by the *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017*.

[2] We have adopted the meaning of this term from the *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017*

a) What types of personal advantage are appropriate vs. inappropriate?

Our members seek further clarity regarding what would amount to "*inappropriate personal advantage*". We have attempted below to list examples of both inappropriate and appropriate personal advantage with a view to having FASEA agree with our understanding. This list could form the basis of a guidance on the topic of "What is appropriate personal advantage"?

Appropriate Personal Advantage:

- referral fees received from other service providers where the client's consent is obtained, the referral fees are clearly disclosed to the client, and the resulting advice is independent of the view of the referring adviser. Such referral arrangements allow advisers to refer clients to other professionals where the clients' needs are beyond the knowledge, skills and experience of the adviser;
- fees (including remuneration) received by the adviser where the advice is provided in the best interests of the client, and the fee does not breach the ban on conflicted remuneration;
- where the personal advantage gained by the financial adviser is not at the cost (financial or otherwise) of the client; and
- discounting arrangements with platform providers whereby advisers receive discounts which are wholly passed on to the client.

Inappropriate Personal Advantage:

- referral fees received from other service providers where the fees are not disclosed to the client and/or the referral fee could reasonably be expected to influence the choice of financial product recommended or the advice given to the client;
- where a personal advantage is obtained in circumstances where its receipt or the advice given would result in a breach of the law (such as, the ban on conflicted remuneration or the best interest duty); and
- where the client is vulnerable in some respect and the financial adviser has taken advantage of that vulnerability.

b) What might be the unintended consequences of the current draft?

An unintended consequence may be that an arrangement which does not breach the law could be perceived as providing an inappropriate personal advantage to an adviser in circumstances where the prohibition of such an arrangement may not benefit clients. We suggest that FASEA develop guidance around this issue in order to avoid confusion and unintended consequences.

c) How might the Standard be expressed to avoid unintended consequences?

One possible alternative could be replacing the words "*inappropriate personal advantage*" with "*personal conflict of interest*". The concept of a conflict of interest is already used throughout the Act, and in other codes of ethics; and is widely understood by the industry, and (we believe) the broader public. This may provide greater certainty to advisers and would enable industry to enhance many measures which are already in place. We do not see any benefit to customers in adopting the terminology of "*inappropriate personal*

advantage" given the receipt of such an advantage would no doubt give rise to a conflict between the interests of the client and the adviser.

How do the other Standards respond to this type of consideration?

Standard 1:

It will be difficult to measure whether a financial adviser is acting in accordance with the spirit of laws and regulations, as opposed to just the letter. While we agree with the Standard's intention, we suggest FASEA provide further guidance (including case studies) to assist the interpretation of this standard.

Standard 3:

We seek guidance as to how a financial adviser can act "*as an independently minded professional*", particularly in circumstances where he/she is unable to use the term "*independent*" under section 923A of the Act. Further, this terminology may challenge a Licensee's ability to provide guidance to its financial advisers and determine its own standards of ethical behaviour.

Standard 4:

Regarding the term "*informed consent*", it is not clear what documentation the adviser need obtain from the customer in order to satisfy this obligation. Commentary from the High Court suggests there is no precise formula to determine in all cases if fully informed consent has been given[3]. We submit this wording is subjective. Therefore, an analysis of the mind of each customer would be required in order to determine whether this obligation has been met.

Additionally the word "*free*" is also problematic as it could be perceived that consent was given in circumstances where the client is not paying a fee to the adviser.

Standard 4 could be expressed to avoid unintended consequences as follows:

- Use the words "unfettered, prior and clear consent"

Standard 5:

We note that there is duplication between this proposed standard and the Best Interests Duty ("**BID**") and expect that the Monitoring Bodies will adopt the same approach as the regulator in respect of monitoring and enforcement of this Standard.

Additionally, we consider the words "*terms easily understood by the client*" to be subjective, and reiterate our submissions in *General Comments on the Proposed Standard*. We consider that advice documents required under the Act already provide mechanisms for additional context and commentary to support clients who require further explanation.

[3] *Maguire v Makaronis* (1997) 188 CLR 449; [1997] HCA 23 at CLR 466.

Further, the adviser does not control the content of a product's Product Disclosure Statement ("**PDS**") so cannot ensure that products are presented in terms easily understood by the client. This is a matter for the issuer.

Standard 5 could be expressed to avoid unintended consequences as follows:

- delete the reference to "*product*" so that it reads "*Ensure that all advice is:....*"; and
- Amend "c" to read: presented in ordinary terms to ensure a reasonable client understands the advice presented to them.

Further, we seek guidance from FASEA as to what is easily understood by a reasonable client.

We suggest to introduce the concept of a "reasonable client" to mitigate any issues which arise out of a more subjective test that would be associated with using the word "client".

We are of the view that the current approach of providing advice documents and supporting documentation would be sufficient under the Code. Such guidance could inform Monitoring Bodies and ensure they adopt a similar approach to that of the regulator.

Standard 6:

We are concerned by the use of the words "*broad effects*". We would like confirmation that considering the broad effects on a client from acting on advice is consistent with the BID safe harbour steps (f) and (g) in section 961B of the Act. Further, this wording could be interpreted to require an adviser to provide advice on matters outside of his/her authorisation; for which he/she he has no knowledge, skill or experience; or are out of scope of the requested advice.

In order to avoid any unintended consequences, we seek guidance from FASEA on the term "*broad effects*". We expect that such guidance will also inform Monitoring Bodies when undertaking their monitoring and enforcement activities.

Standard 7:

See our comments on the term "*informed consent*" under Standard 4.

Further, we suggest that guidance regarding this Standard should detail the documentation an adviser can rely upon to demonstrate compliance.

Standard 8:

See our comments on the term "*informed consent*" under Standard 4.

Standard 9:

As indicated above, the adviser does not control the content of a PDS, therefore he/she cannot ensure that its contents are not misleading or deceptive. Advisers can ensure their advice and product recommendations are not misleading or deceptive, use reasonable care and diligence in researching and preparing advice, and only recommend products from reputable product manufacturers, but they are not in a position to check all information they receive from issuers. Further, they cannot be sure that the information a client has provided is not misleading or deceptive.

Regarding the use of the word "*competence*" we seek clarification on what measures FASEA anticipates an adviser will need to undertake to demonstrate "*competence*".

Standard 9 could be expressed to avoid unintended consequences as follows:

- Amend so that it reads:

  "Ensure that all advice (including advice on products) are"; and

  (b) "based on information that, as far as the relevant provider is aware, acting reasonably, neither misleading nor deceptive"

Standard 10:

The FSC assumes that by meeting FASEA's education pathways (once finalised) advisers will have met the required standard to "*develop*" a high level of relevant knowledge and skills.

Further, by meeting FASEA's Continuing Professional Standards (once set), advisers will have met the requirement to "*maintain*" a high level of relevant knowledge and skills.

We seek confirmation from FASEA on these points.

Standard 11:

We note that the role of the Monitoring Bodies is subject to ASIC's *Consultation Paper 300 Approval and oversight of compliance schemes for financial advisers,* and may provide comment to ASIC as appropriate.

We suggest Standard 11 be amended so that only actual breaches and not "*potential breaches*" are the subject of disciplinary action.

Standard 12:

We note that there are other Codes of Ethics that apply to advisers[4]. We seek guidance from FASEA as to how its Code will interact with other Codes of Ethics.

We also seek clarification as to how FASEA intends to protect whistleblowers.

2. *The **practical application** of the proposed Code in terms of:*

   a. *Adviser practice*

[4] For example: the Tax Practitioners Board Code of Professional Conduct, Financial Planning Association's Code of Professional Practice

Should FASEA provide guidance on each standard as we have requested, we consider that this will greatly assist the implementation and application of the Code for both Advisers and Licensees.

We believe that the vast majority of advisers act in their clients' best interests, and that only a small minority are what has come to be known as 'bad apples'. We are hopeful that the application of the Code may be impetus for these 'bad apples' to leave the industry as it becomes too difficult for them to continue with their current practices.

We note the following impacts of the Code on Licensees and Adviser practices:

- the advice process may require additional documentation to be signed by the client to evidence the adviser has complied with the Code; and
- significant costs will be incurred in updating document collateral.

b. Licensee practice

In addition to the comments under Adviser Practice that also apply to Licensees (where indicated), there is a concern that a Licensee may be required to sign up to multiple Monitoring Bodies in the event that their advisers do not all sign up to the one body. Licensees could incur significant additional cost for each Monitoring Body, and the monitoring and enforcement of the Code may differ from body to body.

c. Education and support

We seek clarification as to how FASEA intends to support the launch of the Code to advisers and Licensees. It might consider producing support materials that can be placed in advisers' offices and on their websites with a view to continually reinforcing appropriate standards of behaviour.

We understand that FASEA intends to ensure all advisers undertake a bridging course focussed on the practical application of the Code, and applaud this initiative.

d. Compliance requirement

It is difficult to make an assessment of the compliance requirements in any great detail at this juncture. We expect that the Code would not mandate steps in the advice process that are additional to the BID safe harbour steps set out in section 961B.

Additionally, it ought be remembered that compliance requirements to meet the Code will be in addition to the existing requirements for other codes of ethics.

e. *Consumer experience*

Consumers will only be aware of the Code if there is an appropriate awareness campaign. We would expect that, once implemented, advisers will publicise the fact that they comply with the Code to existing and prospective clients.

The Code and its monitoring and enforcement should raise the standard of adviser conduct, with consumers benefitting from higher quality advice.