



22 November 2019

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Dear Mr Glenfield

**Re: FG002 Financial Planners and Advisers Code of Ethics 2019 and Guidance**

The Australian Financial Markets Association (AFMA) welcomes the opportunity to make comment on FASEA's recently published Guidance relating to the Code of Ethics and the Code of Ethics itself.

AFMA welcomes the Financial Planners and Advisers Code of Ethics 2019 (Code) and FG002 Financial Planners and Advisers Code of Ethics 2019 Guidance (Guidance) as mechanisms to lift standards of professionalism across the industry.

AFMA recently participated in FASEA's workshop on the Guidance to the Code of Ethics. We found this a very worthwhile exercise and thank FASEA for the opportunity to be involved. This letter responds to the invitation to provide further comments in writing.

*Consultative Process*

We appreciated the opportunity to attend the workshop and would encourage FASEA to take this more open and consultative approach much earlier in the policy design process. The industry is supportive of good policy and is keen to work together for the benefit of the jurisdiction.

With regard to the optimal level of public engagement in the policy process we would encourage FASEA to consider the work of Archon Fung in the influential 2006 article

*Varieties of Participation in Complex Governance*<sup>1</sup>. Fung offers a taxonomy to assess the inclusiveness of consultation processes along three axes of a ‘democracy cube’.

FASEA’s consultation processes certainly prior to the workshop is on the left on each of Fung’s axes.

Earlier and more empowered engagement with the public is likely to produce regulatory outcomes that are more robust and have broader support with the public. Many of our concerns with the current draft Guidance appear to result from a level of disconnection from the knowledge and guidance of the regulated population from those drafting the rules. In contrast good consultation practice can assure a good level of connection with practical realities in provisions.

Given the breadth of the providers and services that fall under FASEA’s mandate it is likely that any drafting team, no matter how knowledgeable, is unlikely to be fully across the potential impacts of regulatory proposals across the whole industry unless they are deeply engaged with the industry from an early stage.

We would suggest at a minimum FASEA consult on matters with an issues paper inviting feedback, followed by a responses/consultation paper, and then a draft instrument/standard etc.

It is incumbent upon those tasked with consulting with the public to ensure the Government allows sufficient time and resources allocated to this task. Ultimately this will be to the benefit of government as it will result in higher quality and less problematic policies being drafted.

#### *Need to Broaden Model Approach*

It is entirely understandable that FASEA approaches its task with a model of a typical regulated individual in mind when drafting standards and guidance. It is clear from the FASEA’s publications that typically a model is used of a financial advisor providing full scope advise in a small practice.

The level of reliance on this single approach so far has resulted in a number of roles within FASEA’s scope not being well catered-for. For example, the courses required of advisors and the examples used in the ethics exam are often inappropriate for those with a stockbroking background including as they do considerations of insurance and superannuation. The examples in the Guidance are similarly focussed on providers of full-scope personal advice.

AFMA’s view is that a wider set of model cases should be developed by FASEA and used when developing policy to better reflect the diversity of practices within the industry.

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<sup>1</sup> Fung, Archon (2006), 'Varieties of participation in complex governance', *Public Administration Review*, 66 (S1), 66–75. <http://faculty.fiu.edu/~revellk/pad3003/Fung.pdf> Revisited in 2015 in Fung, Archon. "Putting the Public Back into Governance: The Challenges of Citizen Participation and Its Future." *Public Administration Review* 75.4 (July/August 2015): 513–522. <http://archonfung.net/docs/articles/2015/Fung.PAR2015.pdf>

For example, a stockbroker and an advisor employed in a large firm might be worthwhile models against which to check standards and policies.

#### *Role of Guidance*

AFMA notes FASEA's comments around the Guidance being a living document and commentary suggesting it is not creating law.

While guidance is not a legislative instrument it certainly does have legal influence and thereby creates a normative standard. In court cases, in enforcement by regulators and in Royal Commissions, guidance from regulatory and standards agencies and indeed industry bodies is often held up to demonstrate the community expectations for norms of behaviour, which will be enforced.

In part for these reasons firms typically seek full compliance with guidance, noting that guidance does offer the flexibility that firms can seek to achieve similar outcomes via different mechanisms.

This commitment of industry to guidance is one to be supported.

Given the approach of the industry to FASEA Guidance is consistent with the approach to APRA and ASIC guidance we would suggest that FASEA approach the design and drafting of guidance in a way that is consistent with these regulators, in essence more structured and formal.

Guidance should not be released until it has been appropriately consulted on and considered by the regulated community to ensure it is workable and therefore credible.

Similar principles apply to considerations around who is responsible for enforcement. It is of no comfort and nor should it be for firms that enforcement in the first instance falls to the licence holder and ASIC is only relevant at the licencing level.

#### *Code of Ethics Standard 3*

While the majority of this submission concerns the Guidance, there is one major outstanding issue with the Code of Ethics in the drafting of Standard 3.

The consensus view of the industry is that Standard 3 is not workable in many circumstances is at odds with the legislative framework and risks substantial disruption to the industry if its drafting is not corrected.

Particularly as this is a legally enforceable standard it is imperative that it is corrected as a matter of priority by FASEA.

Standard 3 states:

You must not advise, refer or act in any other manner where you have a conflict of interest or duty.

In actuality, there will be many circumstances where individuals and firms will have conflicts and it is still entirely appropriate to act, as long as their conflicts are appropriately managed.

AFMA does not agree with the proposed constructions by FASEA that purport to allow ‘potential’ conflicts to exist as long as they do not become ‘actual conflicts’.

This line of reasoning is not compatible with well-established legal norms of interpretation around conflicts of interest and their management. Conflicts continue to exist even if they are not acted on. As such while ever there is what FASEA might term a ‘potential’ conflict from a legal perspective there is an absolute ban imposed by the standard on advice, referral and action.

AFMA disagrees with the reasoning proposed in the workshop that as the guidance suggests “The Code of Ethics must be read and applied as a whole” this means that individual standards can be decreased in importance if other elements are being complied with. The relevant section in the guidance is:

You will not breach Standard 3 merely by being a duly remunerated employee of an entity that lawfully provides retail financial advice and services, provided that the provision of that advice and services are in the best interests of your client and comply with the other provisions of the Code.

This is inaccurate. Compliance with ‘other provisions of the Code’ will not influence whether an employee has a conflict or is in breach of Standard 3.

Brokerage is likely to be in direct conflict with this standard despite the fact that many back-office costs (clearing, settlement, market data) are often directly or indirectly linked to the volume and value of trades completed. Again, the use of a more diverse range of models or earlier consultation would have brought this issue to the surface.

The standard legal approach to interpreting standards is that all provisions must be complied with at all times.

This will also be the view that ASIC will take when enforcing licencing conditions.

The code as written is what will be primary and any commentary or interpretive suggests by FASEA will be unlikely to significantly influence the application of these legal norms by regulators, courts and commissions.

FASEA must accept that these standards of interpretation are beyond its powers to influence in a meaningful or lasting way.

**Standard 3 cannot be fixed through the application of guidance. It is essential this standard is remedied by redrafting that will accommodate appropriate management of conflicts of interest.**

While we have many concerns around the examples, commentary and ‘disinterested person’ test (which may not be workable) in the guidance for Standard 3, given the need for fundamental reform of the Standard itself, we will limit our discussion to the Standard itself and not the related guidance at this time.

### *Need for Consistency with the Legislative Framework*

AFMA accepts and supports that standards and guidance will go beyond the legislative minimum. This is entirely appropriate, however, standards and guidance should be consistent with the legislative framework and should not be counter to it.

Broadly, and consistent with regulatory practice globally among regulators, the legislative framework should fill out the big picture directions which are then supplemented by more flexible regulation, standards, codes and guidance provide colour and detail of the broader picture.

Where a practice has been specifically approved in the legislative framework it is incompatible with the proper role of standards and guidance to contradict this decision of the Parliament.

For example, stamping fees were after a considered process by the Parliament carved out from the FOFA reforms as an acceptable practice. Yet Standard 3 would likely rule this practice out. This is not going beyond, this is going counter to the legislated framework.

Similarly, as discussed below the rules for determining wholesale clients are clearly and expressly set out in legislation. The Guidance appears to try to rewrite this legislation as not being deterministic. This is inappropriate and possibly invalid.

FASEA should restrict the use of codes and guidance to their proper purpose of supplementing the legislative and regulatory framework.

### *Wholesale Retail Distinction Must be Maintained*

Example 2 as indicated in the discussion during the workshop raises concerns around a potential watering down of the critical wholesale/retail distinction. This is an important structural element in the economy that allows efficient access to wholesale services for high net worth individuals.

Many firms have stopped providing services to retail customers in order to ensure they are not captured by the associated cumbersome regulatory structures. Any suggestion that the retail distinction is no longer as clear as it is legislated risks a further retreat from the provision of services to individuals. Firms should be able to rely on accounting certificates as per the provisions in the Corporations Act.

More generally the Guidance should also be specific that it does not apply to wholesale relationships.

### *General Advice/Personal Advice Distinction*

AFMA is concerned that example 11 suggests that there may be no circumstances in which it is possible to provide general advice. If to comply with Standard 2 providers must undertake sufficient investigation of a client's circumstances to establish that providing general advice is consistent with the client's needs, wishes, and purpose for which the advice is being sought. Doing so unless a clear and simple procedure is provided could readily involve undertaking the same process as would be required for personal advice.

At this point there would be a risk that clients would be of the impression they were being given personal advice. A recent court case *Australian Securities and Investment Commission v Westpac Securities Administration Limited* [2019] FCAFC 187 suggests that this type of enquiry can create a situation where it might not be possible to provide general advice. Giving general advice could place the advisor at risk in these circumstances.

We suggest that where it is clear that the client understands the difference between general and personal advice and the client only wants general advice/execution-only service or declines personal advice that providers should be free to provide general advice without the risk of a suggestion by the Guidance that this could be in error.

### *Scope of Advice*

AFMA holds that limited scope advice can be an important contributor to meeting the needs of clients in a proportional way. Limited scope and scaled advice can assist in making advice more accessible by reducing the significant costs from what might be required for full scope personal advice. Regulatory requirements have already made financial advice less accessible.

Limited scope advice can be an efficient and effective way of dealing with priority items. It can also be required by those offering broking services. There are many highly experienced professionals that can provide the best advice possible on share transactions, that they might not also be experts on insurance should not prevent them providing services of a limited scope.

FASEA should look to support the appropriate provision of limited scope advice with supportive guidance.

### *Value for Money*

As raised at the workshop there is a large subjective element in the requirements to ensure clients are getting value for money. AFMA is concerned that while FASEA was supportive of a holistic reading of the code, as written the code could be interpreted without this broader perspective.

Advice from the leading advisors in the field may cost more due to market forces than the same advice from other providers. Similarly, costs in one year might be high relative to service levels but offset the much higher costs incurred by advisors in years where a full review is undertaken.

Clients are still best placed to determine what represents value for money and the competitive mechanisms in a market economy, rather than state sponsored regulator determinations, should continue to be the key mechanism to manage pricing within the economy.

It may be appropriate to reconsider the current code drafting or strong guidance that requires regulators and others apply a holistic lens to the current drafting. Regulators often do not take a holistic reading when looking at guidance.

### *Incomplete Information and Family Members*

We are concerned about the guidance around Standard 2 and Standard 6 as they appear to create obligations that might be in some cases extremely difficult or even impossible to satisfy. Advisors will be largely in practice reliant on information provided by clients. It is not practical to create an obligation for advisors to seek independent assurance of the validity of information provided and that there have been no material omissions.

There may also be practical challenges created by the needs to ensure privacy and confidentiality around the extent to which the needs of family members might be taken into account in certain circumstances.

### *Ancillary Products and Services*

Further clarification is required around the term ancillary products and services. Complex issues arise under the construction put forward in the examples on this point.

### *Forward FX*

While it is not within FASEA's powers to determine which providers are within its scope we note for completeness our interest in providers that offer only forward FX services no longer being covered by the FASEA framework. These providers allow individuals and small businesses expecting future payments or expenses in a foreign currency to lock in exchange rates.

The products are simple, low risk products that have a long successful history. For small businesses and individuals these products can safely be used without a full review of insurance and superannuation plans.

Those that provide these products provide another example of the diversity of providers that are currently within FASEA's mandate.

### *Timing for Guidance Revision*

We note our expressed concerns about Standard 3 requiring substantial revision.

In relation to the balance of changes appropriate to the guidance, given that no consultation had taken place until the release of the final, and that substantial issues remain with the guidance to many of the Code's standards, we would suggest at a minimum a 6 month period of working closely with industry would be appropriate to allow sufficient refinement of the Guidance and examples.

This would align with the typical minimum periods other regulators would assign to such significant and important work.

*Transition arrangements*

Guidance should be released with time until implementation. The commencement of the code on 1 January with the Guidance released in October gives almost no time for firms to make required changes to align with the Guidance. A transitional period of 12 months would be optimal once the Guidance is finalised.

*Conclusion*

We thank you again for the opportunity to participate in the workshop on the Code of Conduct Guidance and look forward to working to further refine the Guidance in the coming months.

Yours sincerely



Damian Jeffree

**Director of Policy and Professionalism**