2 November 2020

Mr Stephen Glenfield
CEO
FASEA Standards Authority
PO Box A255
Sydney South NSW 1235

By email: consultation@fasea.gov.au

Dear Mr Glenfield

Re: Financial Planners and Advisers Code of Ethics Draft Guide Consultation

The Australian Financial Markets Association (AFMA) welcomes the opportunity to make comment on FASEA's Draft Financial Planners & Advisers Code of Ethics 2019 Guide.

AFMA has engaged previously in relation to FASEA's Code of Ethics both in writing and in-person. We provide this brief submission to reinforce our previously expressed concerns.

Code of Ethics Standard 3

Our primary concern remains with Code of Ethics Standard 3.

Standard 3 states:

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

As drafted, Standard 3 is stated in an absolute way that is incompatible with sound practice. 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.

Brokerage being proportionate to investment is appropriate as many back-office costs (clearing, settlement, market data) are often directly or indirectly linked to the volume and value of trades completed. The risks for advisors also vary in proportion to the sums invested. Brokerage was considered in the FOFA reforms and determined to be

appropriate for a range of products. However, on an ordinary reading of Standard 3 brokerage would create a conflict and create a bar to advising, referring or acting.

As this is a legally enforceable standard it remains imperative that it is corrected as a matter of priority by FASEA. As currently drafted, this creates a flawed legal framework for advice.

FASEA has tried to correct the drafting with guidance limiting Standard 3 to cases where there is "an actual conflict". A standard approach to conflict management would view commission payments as presenting an actual conflict that needs to be appropriately managed. The key misunderstanding in the FASEA approach appears to be that a conflict needs to inappropriately influence actions to become an 'actual' conflict.

This is incorrect and incompatible with existing practice and jurisprudence[1]. Conflicts are 'actual' when they merely have the potential to create inappropriate outcomes. They do not need to inappropriately influence outcomes in order to be actual conflicts.

This should not be confused with 'potential' conflicts which are circumstances where there are no incentives to act inappropriately but in the future due to the particular circumstances there could be. David Burfoot a Senior Advisor to the Ethics Centre writing in a 2018 article for IBAC outlines the differences:

> [This is an] actual conflict of interest; you are confronted with a dilemma. You are in conflict between two social values – your professional duty to be objective and your duty to family.
>
> A potential conflict of interest is one that is not actual but, in time, could be. Let's say you work in the IT section of an agency and your brother opens a computer store in the area. You have no tenders out now for IT equipment but it is possible you will hold one in the future which your brother might want to bid for.
>
> A perceived conflict is trickier. In these situations there may be no actual or potential conflict, but someone could think (reasonably, of course) there is one and this can have its own ramifications.[2]

The FASEA Code should represent this standard approach to conflicts of interest by requiring that conflicts be avoided where possible (or where unmanageable) and managed where unavoidable and manageable.

FASEA seeks to portray the actual conflicts associated with commission payments and other matters as only 'potential' conflicts *this is not only inconsistent with the treatment of conflicts elsewhere but likely incompatible with how the code might be reasonably interpreted by the courts and regulators.*

The inconsistency creates legal risks for advisors that their actions will be interpreted as conflicted by the courts and regulators whereas the guide to the code would claim they are only 'potential' conflicts.

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[1] See for example *RBC Investor Services Australia Nominees Pty Limited v Brickworks Limited* [2017] FCA 756

[2] https://www.ibac.vic.gov.au/publications-and-resources/ibac-insights/issue-21/actual-and-perceived-conflicts-of-interest-why-both-matter

While ever there is what FASEA might term a 'potential' conflict, from a legal perspective there is an actual conflict and therefore an absolute ban imposed by the standard on advice, referral and action.

These actual conflicts are typically entirely manageable and there is no concern they cannot be managed in most circumstances. We urge FASEA to address this most fundamental error in the Code. It cannot be addressed through guidance and remains a significant failing.

AFMA disagrees with the introduction and guidance:

> "Relevant providers should not consider each of the values and standards in the Code in isolation. They are intended to operate in combination to strengthen and inspire good practice. As such, the Code should be read and applied as a whole."
>
> and
>
> "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' or the Code 'as a whole' will not influence whether an employee has a conflict or is in breach of Standard 3. The ordinary legal approach to interpreting standards that will be enforced by the courts is that all provisions must be complied with at all times. This is also the approach ASIC takes when enforcing licencing conditions. Conceptually it is difficult to conceive of how a different approach could be constructed to allow breaching of some standards as long as others were adhered to.

The code as written is what will be primary reference point to determine if there has been a breach. Any commentary or interpretive suggestions 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. If FASEA has legal advice to the contrary, we would welcome its release.

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.

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 to 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 carved out from the FOFA reforms as an acceptable practice for many products, after a considered process by the Parliament. 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.

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 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 and those providing simple FX forward services, 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.

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

Wholesale Retail Distinction Must be Maintained

AFMA notes the intention of the standard to blur 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, risky and expensive retail 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.

There is a bright line test defined in the Corporations Act and again we note the importance that the Code works in harmony and not against legislation that has been put in place by the Parliament.

General Advice/Personal Advice Distinction

AFMA is concerned that Standard 2 and Standard 5 suggest that there may be no circumstances in which it is possible to provide general advice. If to comply with Standard 2 and Standard 5, 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, this is likely to create a requirement to provide personal advice and to therefore bar providing general advice.

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 actively chooses general advice/execution-only service or actively 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 far less accessible for many Australians.

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 from 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 valuing their time more 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 and the market 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.

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.

Conclusion

We have raised again through this letter the clear concerns previously noted by industry through various channels. We are concerned that a number of issues remain outstanding including Standard 3 and the narrow focus on financial advisors that does not adequately cater for the wider range of roles that make up the retail finance landscape.

AFMA is committed to assisting the development of a workable framework for the industry that will serve the interests of retail investors well.

Yours sincerely

Damian Jeffree

Senior Director of Policy