Stockbrokers
And Financial Advisers
Association Limited

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Financial Adviser Standards and Ethics Authority

By email: consultation@fasea.gov.au

Code of Ethics -Legislative Instrument
Comments by Stockbrokers and Financial Advisers Association

I refer to the Draft Legislative Instrument and Explanatory Memorandum relating to the Code of Ethics ("the Code") which were released for comment on 21November 2018.

The Stockbrokers and Financial Advisers Association ("SAFAA") provides the comments set out below on the respective Draft Legislative Instrument and Draft Explanatory Memorandum.

Standard 1

You must act in accordance with all applicable laws, including this Code, and not try to avoid or circumvent their intent.

Standard 2

You must act with integrity and in the best interests of each of your clients.

The redrafting of Standards 1 and 2 are a considerable improvement on the initial Draft of the Code. SAFAA has no issues with Standards 1 and 2.

Standard 3

You must not advise, refer or act in any other manner if you would derive inappropriate personal advantage from doing so.

SAFAA reiterates the concerns expressed in our previous Submission relating to the lack of clarity as to what is an "inappropriate" personal advantage. There is a considerable body of legislation surrounding the benefits that an adviser may or may not obtain, so it would be far better and clearer for the Code to refer to "unlawful personal advantage", rather than introduce a brand new term the boundaries of which are not clearly defined or understood.

Standard 4

You may act for a client only with the client's free, prior and informed consent. If required in the case of an existing client, the consent should be obtained as soon as practicable after this Code commences.

The second sentence is unnecessary and should be removed. Either the adviser has the consent or they do not, in which case steps would need to be taken to meet the standard. The additional wording is superfluous.

Standard 5

All advice and financial products that you present to a client must be in the best interests of the client and appropriate to the client's individual circumstances.
You must be satisfied that the client understands your advice, and the benefits, costs and risks of the financial products that you recommend, and you must have reasonable grounds to be satisfied.

SAFAA has concerns with respect of the use of the word 'present' in the first sentence. It is more appropriate that the Standard should deal with 'recommendations'.

SAFAA also has concerns about the drafting of the second sentence. It focusses on an outcome that may be hard to prove in objective terms.

SAFAA recommends the following wording be used instead:

You must take reasonable steps to provide your recommendations to the client in a manner that the client is likely to understand, including the benefits, costs and risks of the financial products that you recommend."

Standard 6

You must take into account the broad effects arising from the client acting on your advice and actively consider the broader, long-term interests and likely circumstances of the client.

There are problems with Standard 6 on a number of levels.

Firstly, the term "broad effects" is very vague. What exactly are the "broad" effects? It is not used anywhere else, and SAFAA questions whether it is capable of being sufficiently clear for an adviser to know how to comply with it.

Secondly, the phrase "broader, long term interests and likely circumstances of the client" is also extremely vague, and impossible to ascertain. Anything could be "likely" in relation to a client – divorce, remarriage, disability, mid-life crisis, and so-on. Advisers do not have a crystal ball, and cannot possibly consider all of these potentialities.

Standard 6 also fails to understand the stockbroking industry, and the nature of limited advice and scaled advice, both of which are permitted under the Corporations Act. For instance, RG244 specifically provides that a stockbroker can provide scaled advice, and notes that "If you are giving scaled advice, you must explain what advice you are providing and what advice you are not providing" (Key points, section E, p 32).

Accordingly, stockbrokers are not obliged to take into account the "broad effects" of the advice that is given to a client, subject to the obligation to ensure that the client understands what the advice is, and what the advice does not purport to do. A client goes to a stockbroker to obtain advice about listed securities and other exchange traded products. The client is not after advice about, for example, Treasury bonds, and a stockbroker is not required to consider whether the client would be better off investing in bonds or to advise the client to do so instead of acquiring shares.

SAFAA submits that a more accurate statement of a Code standard would be something like:

"You must consider whether the advice will meet the client's needs and circumstances, having regard to the scope of the advice being sought by the client."

Standard 7

The client must give free, prior and informed consent to all benefits you and your principal will receive in connection with acting for the client, including any fees for services that may be charged. If required in the case of an existing client, the consent should be obtained as soon as practicable after this Code commences.
Except where expressly permitted by the Corporations Act 2001, you may not receive any benefits, in connection with acting for a client, that derive from a third party other than your principal.
You must satisfy yourself that any fees and charges that the client must pay to you or your principal, and any benefits that you or your principal receive, in connection with acting for the client are fair and reasonable and represent value for money for the client.

There are a number of problems with Standard 7.

Firstly, the words "all benefits …..including any fees for services..." is extremely broad, and covers fees that may be charged at a later point in time by the Licensee, or fees that may by be varied at a later point in time. It is not appropriate to impose a standard on the Adviser that extends to events that may occur well after the advice has been given by the Adviser to the client.

For example, in relation to Stockbroking, brokerage rates may be changed from time to time. This is a matter for the Licensee to notify the client in the manner required under the Corporations Act. The appropriate rate of brokerage will be charged for transactions on behalf of the client, even where no advice has been sought or given e.g. execution-only share trades. The Adviser should not have a Code of Ethics exposure in relation to such charges, although the wording that has been applied above would do this.

One possible way of resolving this is, given that the Professional Standards framework is only applicable where an adviser gives personal advice to a retail client, to change the wording in the First sentence of Standard 7 to:

"…receive in connection with providing advice to the client.."

instead of *"acting for ".*

Secondly, the last sentence in Standard 7 is an impractical standard and should be removed entirely. Who decides what charges amount to "fair and reasonable" or what is "value for money", and on what criteria are such value judgements to be based?

A client may be prepared to pay an adviser a very high fee if they value the advice highly, and the rates of return that the client earns are very high. It is no different to

paying a Senior Counsel very high fees if they are perceived as being the best in the business and likely to win your case, or paying a surgeon three times the scheduled fee if they are more likely to save your life.

Adequate disclosure of fees and prior consent is where the question of fees should begin and end. Clients are well able to compare fees charged for financial advice from different providers, and able to compare the returns from their investments. Clients are able to make their own decisions on what is value for money to them, or what is fair and reasonable.

It is difficult to envisage how the Code Monitoring Body could meaningfully monitor a requirement as worded above if it were to remain in the Code.

Standard 8

You must maintain complete and accurate records relevant to services (including advice) you provide to each client (including former clients).

Standard 8 is a legislative requirement placed on the Licensee. It is not a matter of Ethics, and does not warrant being included in the Code.

In relation to Stockbroking, an adviser will rely on the systems put in place by the Licensee to constitute the records of a share transaction, and statements of advice (to the extent that statements of advice are required). These will invariably involve sophisticated IT systems. Standard 8 as drafted would impose an identical obligation on the adviser – but how is an individual adviser possibly to be in a position to themselves maintain "complete and accurate records"?

SAFAA notes that it made a similar submission in respect of the previous version of the Code, that there was no need for this matter to be dealt with in the Code. In our view, the revised drafting of Standard 8 is even worse than the wording used in the previous version.

Accordingly, SAFAA submits that there is no need at all for Standard 8.

Standard 9

All advice you give, and all products you recommend, to a client must be offered in good faith and with competence and be neither misleading nor deceptive.

SAFAA has no issues with Standard 9.

Standard 10

You must develop, maintain and apply a high level of relevant knowledge and skills.

SAFAA has no issues with Standard 10.

Standard 11

You must cooperate with ASIC and monitoring bodies in any investigation of a breach or potential breach of this Code.

SAFAA has no issues with Standard 11.

Standard 12

Individually and in cooperation with peers, you must uphold and promote the ethical standards of the profession and hold each other accountable for the protection of the public interest.

In our view, Standard 12 is problematic in its entirety, and should be deleted.

SAFAA made the same submission in respect of the previous Draft Code, and we are disappointed to see that the wording of Standard 12 has remained largely unchanged.

As previously stated, the wording is extremely vague, and it is difficult to determine what compliance with the requirement would involve. What steps must an adviser take in order to hold another adviser(s) accountable? And what does acting in co-operation with peers entail? What steps must an adviser take in order to engage with other advisers and meet this standard?

Apart from the vagueness of this Standard, there are serious questions about potential liability, such as under defamation laws, if an adviser where to take positive action in order to comply with an obligation in these terms, such as comment adversely about the adviser in question to other members of the profession.

SAFAA recommends that a preferable wording for a Standard of this nature would be:

"You must uphold and promote the high standards of conduct and behaviour of the profession when you provide services to clients and the community, and not bring the profession into disrepute"

Definition of "Client"

SAFAA notes that interpretation sections defines "client" in the following terms

***client**, in relation to a relevant provider, includes a retail client of the principal of the relevant provider*.

The definition should, instead, read "*in relation to a relevant provider, is limited to a retail client of the principal of the relevant provider*", or some such wording.

The Professional Standards Framework, including the Code of Ethics, has been enacted for and applies to Relevant Providers who provide Personal Advice to Retail Clients. The wider definition of " client", as presently drafted, would potentially apply the Code to Wholesale Clients (including Sophisticated and Professional Investors etc), or to clients who have been provided with general advice.

The above definition of "client" could therefore represent an application of the Code which is ultra vires the Legislation. It could also potentially create a confusing situation where there are two separate standards being applied in relation to Wholesale Clients and to General Advice clients, being one for those clients who deal with a Relevant Provider who is otherwise subject to the Professional Standards framework by reason of their providing personal advice in other situations, and one for those clients who deal with financial advisers who are not subject to the Professional Standards framework at all.

For these reasons, it would be prudent to amend the definition of "client" as we recommend above, to ensure that the Code aligns with the scope of the Professional Standards Legislation.

CONCLUSION

SAFAA does not believe that the latest version of the Code of Ethics is in a form which is appropriate to adopt. At a minimum, the amendments which we propose should be accepted.

A Code of Ethics is best if it is not delivered from the "top down", as is happening in this instance. A better outcome would be achieved if there was better dialogue with all of the various stakeholders to develop a further draft.

We appreciate your efforts in developing the code and trust you view these comments as constructive.

We would be happy to discuss any issues arising from our submissions on this issue. Should you require any further information, please contact Peter Stepek, Policy Executive, on (02) 8080 3200 or email pstepek@stockbrokers.org.au .

Yours sincerely,

Andrew Green
Chief Executive