

Stockbrokers and Financial Advisers Association Concerns with the FASEA Code of Ethics and accompanying Guidance Note November 2019

Introduction

The Code of Ethics issued in February 2019 had fundamental problems. SAFAA advised FASEA of these problems and also set out the problems in writing to the previous Minister (the Hon Stuart Robert MP) in February 2019 and followed up with advice in an in-person meeting in February 2019.

SAFAA was advised by the former Minister that FASEA would issue a Guidance Note that would resolve the issues.

We have sought to engage with FASEA throughout the year. We highlighted that possible interpretations of the standards would be impractical and lead to significant disruption in the profession. We asked that the fundamental issues be addressed and noted that guidance was required promptly to allow our members time to adjust their businesses where necessary.

For most of 2019, we also believed that the Code of Ethics would be enforced by a code monitoring scheme that would understand the financial and investment advice professions and would be able to assist in guiding compliance in a pragmatic and commonsense way. With the government's decision to move away from code monitoring, this role will now be filled by regulators and so clear guidance on the Code of Ethics is even more important.

FASEA advised SAFAA and other industry associations in the first half of the year that it would consult on the Guidance Note before it was publicly issued. That consultation never took place.

The Guidance Note was issued publicly on 18 October — nine months after it was promised and only two months before compliance with the Code is mandatory. Not only did it not resolve any of the previous issues, but it has also compounded them. Given that a central problem is that the Code (and Guidance) conflicts with the law as it stands in many instances, it is impossible for an adviser to know how to comply with the Code.

It is also impossible for this to be resolved by 1 January, as both the Code and the Guidance Note need considerable reworking.

SAFAA's view

- The Code cannot be complied with as it stands. It needs reworking. Currently it is contrary to the law, as well as longstanding accepted practice with which nobody has an issue.
- It cannot be fixed between now and 1 January 2020 as there is insufficient time and also an industry lack of confidence in FASEA, which has consistently refused to engage. Whilst FASEA will say that it is there for the consumer and not the industry, by not engaging with the industry it consistently shows a lack of understanding and knowledge about how markets work. In turn, this is damaging to the consumer, because they have arrived at a Code which basically means no adviser will be willing to give advice to a retail client, irrespective of whether it is financial planning or investment advice.
- Compliance action should not be taken until the Code and Guidance is consulted on and amended – this would see the Guidance and Code withdrawn in order for proper consultation to take place.



- The review and consultation need to be transparent, with all submissions publicly available on FASEA's website and a response document issued showing how FASEA dealt with feedback.
- A two-year transition period is required to allow for this process and then implementation.
- In order to develop a new Code, a new FASEA board is required, one with understanding and knowledge of the different forms of financial advice. For a start, the FASEA Board needs to understand that not all financial advice is financial planning advice.
- Because of the limited size of the board, a board change will not provide sufficient breadth of knowledge to be able to develop a good Code that can apply to the whole industry. This can only be achieved by also implementing a consultative committee, along the lines of the ASX Corporate Governance Council, which has proved over more than a decade to have changed practice and behaviour through the development of a governance code that has buy-in from the whole market. This is something we have urged FASEA to implement for over a year.

Key problems identified in the Code of Ethics and Guidance Note

1. Standard 3: Brokerage

Despite the Guidance stating that the Code needs to be read as a whole, our members are of the view that Standard 3 would make it a Code breach to charge variable commissions. Standard 3 therefore extends beyond current legislation and regulatory guidance.

Stockbrokers here and around the world charge brokerage based on trade value. They have done so for centuries. It applies irrespective of the stock. Brokerage is product neutral.

FASEA's Guidance Note, which we were advised would address brokerage fees, compounds the problem. Example 10 states that brokerage as a flat fee would not be a conflict — yet the only brokers who charge a flat fee are online brokers, where the client enters the order themselves and no advice is provided. Broker commissions were excluded from being conflicted remuneration in FOFA with bipartisan support due to recognition that they are a key element in ensuring that companies can attract capital and investors can seek opportunities.

The Guidance Note contains a general statement: "You will breach Standard 3 if a disinterested person, in possession of all the facts, might reasonably conclude that the form of variable income (e.g. brokerage fees, asset based fees or commissions) could induce an adviser to act in a manner inconsistent with the best interests of the client or the other provisions of the Code.". This establishes a new test that does not exist in legislation. The market has no idea what a disinterested person would say about any form of fees, including traditional brokerage, given that these questions arise: Who is this disinterested person? Would they say that brokerage is OK? Would they not?

High level of impact: Extreme disruption to markets

Brokers have questions as to whether they can trade shares as of 1 January 2020 and charge brokerage fees, as permitted by law, without breaching the Code. Share trading may have to cease on this date unless a new form of charging clients is implemented in the next two months, which is not feasible. ASIC will have to take action against any Licensee who continues to charge variable brokerage. This would cause massive disruption to our capital markets and disadvantage Australia's economy significantly.

2. Standard 2: Scaled Advice

Standard 2 neglects to provide scope for limited or scaled advice that is provided without holistic knowledge of the client's situation as permitted by law.

The Guidance Note fails to understand that stockbroking is "scaled advice" (SAFAA has sought on numerous occasions to explain this to FASEA). A client visits a broker to buy shares and other investments on exchange. They do not go to a broker for a financial plan or for life insurance or bonds, etc. A stockbroker is not a financial planner and is not required to tell a client who comes in to buy shares in a particular company to go away and not buy any shares, but instead put their money in a term deposit. The law permits brokers to accept the client's scope of the engagement and limit the advice to shares/listed investments etc.

High level of impact: Stockbroking as a business breaches the Code

The Corporations Act and ASIC Guidance acknowledges the existence of scaled advice. The Guidance Note, however, indicates that a stockbroker will be in breach of the Code for engaging in traditional stockbroking business. The Guidance Note fails to correct the problems in the Code of Ethics that makes it a potential Code breach if a broker does not undertake a full financial analysis of a client.

3. Standard 2: Incomplete information

The Guidance Note at page 14 is contrary to the Corporations Act and ASIC Guidance and is probably invalid.

The law presently provides for an "incomplete information" disclaimer. It recognises that there are many clients who deliberately DO NOT want to provide all of the information that a stockbroker asks for, for example, income, marital status, etc, for a range of personal reasons. Brokers ask for the information, but the client often does not provide it. They do not want their stockbroker to know anything more than they are happy to tell them. They just want to talk about buying shares on the ASX.

Under the Corporations Act, brokers must give the client the "Limited Advice" disclaimer: "Because you have not given me all the information that I have asked for that may be relevant, my advice might not be appropriate to your needs, and you have to decide for yourself if it is appropriate to you etc".

High level of impact: Stockbroking as a business breaches the Code

Under the Code and Guidance Note, it appears that even if the broker is only providing the client with general advice, for example, "This stock is going up and looks very good", the broker will be in breach of the Code because they should have insisted on all information from the client.

4. Wholesale clients

The Code and Guidance Note contradict the law and ASIC Guidance and are probably invalid, in relation to the treatment of the wholesale client category that is set down in the Corporations Act.

Under the Corporations Act, a client is a wholesale client if one of the tests in the Corporations Act is satisfied. There are a number of different tests, including:

- one relating to sophistication
- one relating to investable assets
- one relating to annual income over a certain amount, and
- one relating to the size of the investment.

The Act is clear — a client who meets any ONE of these thresholds is not a retail client.

The FASEA professional standards regime only applies to retail clients, not to wholesale clients. Under the examples in the Guidance Note, an adviser breaches the Code of Ethics if they give advice to a wholesale client who is not fully sophisticated. In effect, FASEA is stating that a client only meets the wholesale client test if they satisfy the sophistication limb of the Corporations Act definition. This is contrary to the Corporations Act.

If there is a concern with the wholesale clients test in the corporations law, that is a matter for parliament to address through the normal legislative reform process, but it is not FASEA's remit to amend the test.

High level of impact: applies FASEA Code to wholesale clients

A stockbroker will have two options under the Code of Ethics:

1. establish a test for "financial sophistication" and make EVERY Wholesale client complete that test, in order to be able to ensure that the adviser does not breach the Code (presumably, the client will need to be re-tested at various intervals to ensure that they have not lost their level of sophistication over time);
or
2. Get rid of all their retail clients and remove themselves from the Adviser Register completely, so that they are removed from the scope of FASEA.

Conclusion

These are the most drastic of issues that have been identified in the short time available. There are a number of others and more will come to light when SAFAA Members give us their feedback.

The Code and Guidance Note conflict with the law in many respects. This is an attempt to introduce new laws without a proper public consultation process, parliamentary oversight or any of the protections that are brought in through the legislative drafting and exposure draft consultation process. By not engaging with the industry FASEA consistently shows a lack of understanding and knowledge about how markets work. In turn, this is damaging to the consumer, because they have arrived at a Code and accompanying guidance which means advisers are likely to be unwilling to give advice to a retail client, irrespective of whether it is financial planning or investment advice.