Stockbrokers and Financial Advisers Association Limited

22 November 2019

Mr Stephen Glenfield
CEO
Financial Adviser Standards and Ethics Authority
133 Castlereagh St
Sydney NSW 2000

By email: consultation@fasea.gov.au

Dear Stephen

Code of Ethics Guidance Note GN002

I refer to the recent Briefing session for Industry Associations and Licensees in relation to Code of Ethics Guidance Note GN002 held on 13 and 14 November 2019. I also refer to the joint Industry Association Submission in relation to GN002 dated 7 November 2019, to which Stockbrokers and Financial Advisers Association (SAFAA) was a joint signatory, a copy of which has been provided to FASEA. We attach a copy of the Joint Industry Submission as Appendix A for ease of reference.

SAFAA welcomes the announcement made at the Briefing sessions that FASEA would issue a revised Guidance Note before the end of December 2019 and invite written feedback on the current version by 22 November. SAFAA appreciates the opportunity to provide comments to FASEA in addition to those expressed at the Briefings verbally in respect of GN002, and of necessity, the Code of Ethics, which will hopefully lead to industry having more certainty as to the obligations that will shortly come into effect on 1 January 2020.

In the interests of brevity, and due to the very brief period of time available, SAFAA reiterates the feedback provided in the Joint Industry Submission. We refer you to Appendix A for those comments. In this submission we will concentrate on providing further comment from our Members on other issues that have been identified with GN002, that were not included in the Joint Industry Submission, due to the scope of that document.

Recommendations

In light of the Joint Industry Submission and our comments on the following pages, SAFAA is strongly of the view that FASEA should withdraw GN002 released on 18 October. It not only does not assist with understanding how to comply with the Code of Ethics, but further challenges the possibility of compliance. The revised Guidance Note should be developed in consultation with the industry in order to ensure that it addresses how licensees and advisers can comply with the Code of Ethics.

We further recommend that FASEA seek a 12-month exemption from ASIC for advisers from compliance with the Code of Ethics. Licensees and advisers will have mere days in which to digest the revised guidance before compliance with the Code commences on 1 January. We note that FASEA's statement that the Code has been available since February 2019, providing sufficient time for changes in business models to be implemented, overlooks the fact that the industry requested guidance due to elements of the Code being unworkable, given they conflict with the law. That guidance was not made available till late October 2019 and created further confusion and uncertainty, rather than providing practical and sensible guidance. It is simply not possible to state that sufficient time is being made available to the industry to comply with the Code in these circumstances.

Importantly, SAFAA also recommends that FSEA rework the Code of Ethics in order for it to fulfil its objective of supporting ethical duties that go beyond the minimum requirements of existing law, while remaining consistent with the law. We cannot reiterate strongly enough that Standard 3 is unworkable in its current form. It is not feasible for advisers to comply with the expectation that advice will be provided free of any conflict. This is particularly critical given that the Code will be the subject of consideration by bodies other than FASEA, such as Courts, ASIC, AFCA and the like.

Finally, we also recommend as a matter of good governance that all submissions on the GN002 be published on FASEA's website, providing transparency to all stakeholders as to issues that need resolving. This is good policy consultation protocol as practised by Treasury and ASIC.

Additional Issues identified with GN002

1. Standard 3 — **Actual v potential conflicts**. We note FASEA's explanation that GN002 relies for its interpretation on a distinction being drawn between "actual" as opposed to "potential" conflicts of interest. This is a distinction that is not drawn in law, and therefore there is no body of legal judgment or body of experience that allows for an understanding of how to interpret this standard. Consequently, GN002, rather than clarifying the Code of Ethics, makes it even more difficult to interpret.

   Under the widely understood principles of conflicts of interest, a person either has a conflict or they don't. A conflict does not start off being "potential", so that it doesn't become actual if certain steps are taken.

   For GN002 to be clear and understandable, it needs to sit with the centuries of law and learning that explain the area. This is a key reason why SAFAA believes that Standard 3, as presently drafted, is not capable of being fixed by revised Guidance. We are of the view that it is not possible for a Guidance Note to explain what is meant by "potential" v "actual" conflicts, and what steps can be taken for a conflict not to be a breach of Standard 3.

We strongly recommend that revision of Standard 3 is required. We refer you to our earlier comments and those in the Joint Industry Submission at Appendix A.

2. Standard 3 — Example 10, page 22. As mentioned in the Joint Industry Submission, the implication that only flat forms of brokerage are permissible will render much of stockbroking in breach of the Code. GN002 needs to state that a brokerage commission based on a percentage of trade value is not a conflict, and that neither the Licensee nor the adviser will breach Standard 3 by reason of this.

3. Standard 3 — The Guidance Note should expressly deal with the common scenario where an adviser (or a family member) holds shares in a company e.g. CBA, and gives advice to the client in respect of buying or selling CBA shares, or about products owned by the company e.g. a CBA Hybrid. In all existing treatments of the area of conflicts, this is seen as a conflict of interest capably managed by prior disclosure to the client. It should not be a breach of Standard 3. We also note that the adviser in these instances has 'skin in the game', which promotes alignment with the interests of the client.

4. Standard 3 — The "disinterested person" test. This has generated a great deal of comment from members. This is not a test that is used in the legal system and there is therefore no precedent or background that gives any idea what it means. Introducing a brand-new test does not provide any guidance or clarity, rather, it creates enormous uncertainty. This test needs to be deleted from the Guidance Note.

5. Standard 2 — refer to our comments in the Joint Industry Submission.

   Page 11, Example 2 — The following statement appears confused:

   > "Wallace's conduct also breaches **Standard 2**. By treating Donna as a wholesale client, he benefits by not having to comply with retail client disclosure laws and the best interest duty and related obligations. "

   Standard 2 does not relate to obtaining of benefits, rather, it relates to acting with integrity in the best interests of the client.

6. Example 2 is in itself a poorly written scenario – a company's share price may suffer a sharp fall for a variety of reasons, which may or may not be related to any misconduct. This does not automatically mean that advice was not in the best interests of the client at the time it was given. A company may be found to have been in dubious financial circumstances, but this may not be known to the market. There seems to be an assumption in Example 2 that Wallace knew or

should have known this about Vubberlife when he gave the advice that he did. There may have been many firms with a Buy recommendation on Vubberlife at the time of the advice, prior to its circumstances becoming known, and Wallace's advice may have been entirely consistent with those views.

7. Page 14 — This section of GN002 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. The revised Guidance Note must make clear that an adviser who gives advice without all of the information that was requested of the client, and who gives the appropriate disclaimer that is provided for in the Corporations Act, does not breach the Code of Ethics. As we state in the Joint Industry Submission, there are many clients who deliberately choose not to provide some or all of the personal information requested by a stockbroker. The legislation expressly recognises this. There should not be an onus on the adviser to engage in a fact-finding exercise using other possible avenues, to find out what the client did not want to disclose to the broker. This is another example of the emphasis in GN002 on financial planning and the lack of recognition of other forms of advice, such as investment advice, having a significant negative impact on advice professions other than financial planning.

8. Page 16 — The Guidance needs to expressly recognise that stockbroking is scaled advice. There should not be an onus on a stockbroker to consider whether a limited scope engagement is appropriate for a client who consults the stockbroker because they want to start a share portfolio. As we say in the Joint Industry Submission, in requiring an adviser to consider "broader long term interests", Standard 6 must not be interpreted to require a stockbroker to consider whether the client who wants to buy shares should instead take out a life insurance policy or a term deposit. The Guidance should provide a clear statement to this effect.

9. Example 9 — The entire drafting of this example is unsatisfactory. The reference to a 6.5% fee is gratuitous – SAFAA has research showing that stamping fees are in the order of 1.0 – 1.5% and are never as high as 6.5%. As acknowledged in the Example, stamping fees are a form of remuneration that was specifically exempted with bipartisan support under FOFA from the conflicted remuneration prohibition on policy grounds. In line with our comments in respect of Standard 3 above, GN002 should be clarified to acknowledge that stamping fees are permissible provided they are disclosed. The discussion as to why there is a conflict in Scott, or his principal, retaining them, or not retaining them, serves no purpose and should be removed from the GN.

   As to whether there should be any discussion of whether an adviser acts ethically by rebating the stamping fee to some clients but not to others, we query what the difference is between an adviser who waives a brokerage fee for some clients for a particular reason, but not for other clients, or an adviser who charges a lower fee for premium clients than for other clients. This is a

commercial matter, not an ethical matter. If the Guidance Note wants to deal with this topic, then it should be drafted very clearly so the point of the Guidance is clear and easily understood.

If the purpose of the Example is simply to state that an adviser who markets a product to clients that they do not think is any good, purely in order to earn the fees, is unethical, then it should be revised to more accurately reflect this, without the extraneous, confusing material.

10. Example 10, page 22 — We reiterate our earlier comments and those in the Joint Industry Submission about the implications of the reference to fixed fee brokerage being acceptable, given that brokerage fees from full service brokers are variable and this is the global practice.

11. Example 11 — This example is drafted confusingly. The nature and title of the Example suggest that it relates to "informed consent to general advice", which is a misconception and is potentially in conflict with the law.

    A general advice disclaimer can validly be given under the Corporations Act and does not require the consent of the client. The Code of Ethics should not conflict with the law.

    If the Example was meant to convey that marketing complex products to clients who are not sophisticated is unethical, then the Example should be more clearly titled, and this should be the essence of the Guidance. This topic is in fact treated in a better way in Example 12.

    As to the General advice aspect, if the Example meant to convey that the client, for reasons of language or some other failure of comprehension, did not understand the disclaimer, then this should be made clear. It is one thing to require that an adviser to take reasonable steps to satisfy themselves that the client understands the nature of the advice given, including the disclaimer; however, GN002 is impliedly going further and placing additional requirements on General advice disclaimers that are not in the Act.

12. Example 14 is very questionable. The quality of the SOA template may raise a number of issues, including whether or not the Licensee satisfies its License and disclosure obligations under the Act. Frank raising these issues with his Licensee relates more to his actions as an employee to assist the Licensee to meet its obligations, rather than representing a useful illustration of upholding the ethical standards of advisers, in conjunction with other advisers.

    It would be far more helpful if the Guidance Note were to provide examples of the steps that an adviser is expected to take when they come across conduct by other advisers, including those within the same firm, and those outside the firm, which falls short of ethical conduct.

13. Standard 6, page 29 — We refer to our previous comments in the Joint Industry Submission and above about the scaled nature of stockbroking advice. Clients will to a large extent set the parameters within which advice is given. Standard 6 is drafted in relation to financial planning, not stockbroking. A client who wants to trade in speculative stocks, or Exchange Traded Options, seeks short-term profits. They do not want consideration of their broader, long-term interests or likely circumstances. It is difficult to apply Standard 6 to a vast range of scenarios in stockbroking, and therefore in the absence of changing the standard itself, the limited application of the Standard to stockbroking should be expressly acknowledged in the Guidance Note.

14. Standard 6 — One issue that has been raised, aside from the previous issue, is how to treat inter-generational issues. The interests of the adviser's client may be at odds with the client's spouse, children or other family members. The Guidance Note should provide clear guidance as to how an adviser can satisfy Standard 6 in this situation.

    Further, nowadays, the long-term circumstances of any client may in all likelihood include any or all of divorce, further marriages, blended families, grandchildren, aged-care confinement- and a host of other circumstances that are not at all improbable. There needs to be guidance in the revised Note as to whether, and how, a stockbroker should consider all of these matters in connection with giving stockbroking advice to a client, in order to satisfactorily consider the "broader, long-term circumstances" in compliance with Standard 6.

15. The Code and Guidance Note contradict the law and ASIC Guidance 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 though the normal legislative reform process.

CONCLUSION

SAFAA appreciates the opportunity to provide this additional material to FASEA in relation to GN002. We have relied on the important contribution from our Member firms, who are in the process of reviewing GN002 as it applies to their businesses.

SAFAA strongly recommends that the draft of the revised Guidance Note promised by you at the recent Briefing be circulated to industry associations for review before it is publicly released, to ensure that it genuinely provides guidance and does not add further to the confusion. Of particular importance is that FASEA not seek to rewrite the law that applies to investment and financial advice, but provides sensible guidance to the investment and financial advice professions that is practical and consistent with the best interests of clients.

Given the extremely tight timelines involved, with compliance with the Code commencing on 1 January 2020, any review by industry associations would of course be undertaken as promptly as possible. We cannot stress enough that to issue a revised Guidance Note in December that does not address the problems in GN002 or further exacerbates them will create significant anxiety as to how the industry is to comply with the Code, which is not in the interests of retail clients.

Yours sincerely

Judith Fox
Chief Executive Officer