Stockbrokers and Financial Advisers Association

2 November 2020

Mr Stephen Glenfield
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By email: consultation@fasea.gov.au

Dear Stephen

Financial Planners & Advisers Code of Ethics 2019 Guide
October 2020

The Stockbrokers and Financial Advisers Association (SAFAA) is the professional body for the stockbroking and investment advice industry. Our members are Market Participants and Advisory firms which provide securities and investment advice, execution services and equity capital-raising for Australian investors, both retail and wholesale, and for businesses. Practitioner Members are suitably qualified professionals who are employed in the securities and derivatives industry.

SAFAA welcomes the revised *Financial Planners & Advisers Code of Ethics 2019 Guide* (revised Guide) to the FASEA Code of Ethics (the Code), as the original Guide dated October 2019 generated significant criticism. We appreciate that a different approach to form has been taken in the revised Guide, with fewer examples and an attempt to focus on principles. We appreciate that the revised Guide is clearer than the original. However, SAFAA is of the view that there is little substantive change between the guidance to the Code issued in October 2019 and the guidance issued in October 2020.

Revised Guide does not address concerns with drafting of Code

SAFAA regrets to advise that the revised Guide continues to offer significant challenges to the stockbroking profession and offers limited assistance in clarifying how advisers are to apply the Code of Ethics to their broking and investment advice practice. We also stress that the lack of understanding evinced by FASEA about how stockbroking differs from financial planning continues to present challenges.

The focus of most concern remains Standard 3, which changed from the original wording of:

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

to

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

This significant amendment to Standard 3 was undertaken without consultation and the Standard remains unworkable in practice, particularly in light of the lack of a test of materiality or proportionality. We provide further comment on this on page 4 in our detailed comments. The revised Guide has not addressed the problem inherent in the wording of Standard 3.

The other significant challenge is due to the fact that the Standards (principles) in the Code are drafted in very 'black and white' terms and there is a conflict between these principles and the prescriptive requirements in the Corporations Act. At the SAFAA 2020 virtual conference, Ashurst Partner Jonathan Gordon commented that the Royal Commission recommended that financial services regulation should move away from prescriptive requirements in law to principles-based regulation. However, he also noted that the government has not removed the prescriptive requirements in the Corporations Act applicable to the provision of financial advice. Therefore, the interaction of the principles in the FASEA Code of Ethics with the provisions in the Corporations Act presents a significant challenge to all advisers.

The obligation to comply with the Code is a financial services law and is enforceable. As a result, it has equivalent weight to every other provision in Chapter 7 of the Corporations Act. Failure to comply with the Code leads to significant breach reporting; ASIC investigation powers; the capacity of a court to enforce those provisions; and the capacity of customers to seek compensation orders for a failure to comply with a financial services law.

When the Courts, AFCA and ASIC look at compliance with the Code, it will be done with the benefit of hindsight. The Courts are already giving extended meaning to the enforcement of the obligations in the Corporations Act to adequately manage conflicts of interest and acting efficiently, fairly and honestly and they are likely to give extended meaning to the obligations under the standards in the Code of Ethics.

FASEA is on the public record as stating that as long as an adviser meets the values of the Code, they meet their obligations to comply with its Standards. However, the Courts, AFCA, ASIC and lawyers will give the terms legal meaning and that is where the challenge lies, as legal interpretation of the Standards will be different from FASEA's interpretation. This is unavoidable, given the legislation to introduce a single disciplinary body will not be introduced until mid-2021 and that body will therefore not be established until the end of 2021.

FASEA has frequently expressed its views on the intent of the Code, including in the original and revised guidance, but the challenge is that it will not be FASEA that interprets compliance with the Code, as noted above. Regardless of FASEA's intent in the original and revised Guide, it will still fall to others to enforce compliance or seek recourse through the Courts.

We also note that:

- it is unclear if the revised Guide replaces the original Guide released at the end of 2019 or whether the two guides are meant to work together. Clarity is required from FASEA on this key issue.
- no broking firms were consulted in relation to the revised Guide, which would have clarified that the financial planning lens applied to both the Code of Ethics and the original guide continues to apply to the revised Guide. While SAFAA was consulted much earlier in the year, it was in relation to the original guide and the explanatory response to submissions issued by FASEA at the end of 2019 rather than the revised Guide. We did make the comment that fewer examples and a more principles-based approach would help in any revised Guide and appreciate that this has been taken on board.

Challenge for stockbrokers

Unlike financial planning, stockbroking has existed for many centuries and is highly regulated, governed by the ASIC Market Integrity Rules. The profession has made an incredible contribution to Australians' economic strength, not only in terms of personal wealth creation, but also in the all-important equity formation for Australian companies, ranging from CSL, BHP and CBA down to the smallest and smartest technology and science successes.

The key challenge in being subjected to a Code of Ethics and the original and revised Guide aimed at the financial planning industry is that stockbroking provides a different service to clients and is remunerated differently from financial planning. Stockbrokers often work hand-in-hand with financial planners to advise clients. The planners

provide an overall plan in relation to investment needs, superannuation and insurance. Stockbrokers and investment advisers provide advice and execution and management in relation to the investment component and this is largely in the listed equities and fund markets. SAFAA also notes that a number of its members offer financial planning (wealth) services. We therefore clearly support financial planning and its role in providing Australians with confidence in their financial decisions and the opportunity to generate wealth.

However, until FASEA appreciates that while the legislation refers to 'financial advice' and 'relevant providers' as an umbrella definition, there is not a 'one-size-fits-all' financial advice model, stockbroking will continue to be challenged by the attempts by FASEA to 'fit' it into a financial planning model. Referencing in the title of the revised Guide that not all financial advisers are financial planners and referencing stockbrokers in parts of the text does not mitigate the lack of understanding evidenced in the Code and revised Guide of how stockbroking differs from financial planning as an advice service.

Recommended solutions

In order to ensure that the FASEA Code of Ethics and any accompany guidance can be applied, SAFAA recommends the following solutions:

Standard 3 — The Code should utilise the wording of the Intent as Standard 3, so that the Standard states: 'Advisers must not advise, refer or act in any other manner where they have a conflict of interest or duty that is contrary to the client's best interests.'

Withdraw the original guidance issued in October 2019 — FASEA needs to withdraw the original guidance issued in 2019 — and its response to that guidance — and clarify that the final revised Guide that will be issued following this consultation constitutes the sole guidance.

Revised Guide: FASEA should ensure that all professions are taken into account in the guidance rather than a one-size-fits-all financial planning model being applied.

Changes to the Code of Ethics: FASEA should abide by section 17 of the *Legislative Instruments Act* (Rule-makers should consult before making legislative instruments), which sets out the key preconditions before a legislative instrument can be made and registered in parliament and ensure that any proposed changes to the Code are subject to public consultation.

Our detailed comments follow.

Detailed comments

Standard 1

While the revised Guide to Standard 1 is clearer than in the original version, the issue remains that it continues to refer to wholesale clients in a document that only applies to advisers providing personal advice to retail clients. The revised Guide makes it clear that an adviser can no longer safely rely on the black and white test in the Corporations Act in relation to wholesale investors, including the accountant's certificate in regard to clients who meet the sophisticated investor test, or the criteria set out in the Corporations Act for professional investors.

The key problem is that the original and revised Guide to the Code create a distinction between a licensee that is only authorised to give advice to wholesale clients and a licensee authorised to give advice to wholesale and retail clients, as the Code does not apply to the former. Guidance to the FASEA Code of Ethics is not the place to create

such a distinction. Any changes to the wholesale investor test or policy proposal to create a distinction between licensees with the same client base should be dealt with under legislation through the parliamentary process.

Standard 2

The revised Guide to Standard 2 (and this arises elsewhere in the revised Guide) raises the issue of why it is unacceptable for an adviser to do what the client wants. SAFAA members are of the view that acting in the best interests of the client is providing advice so that the client can make an informed decision. However, there can be circumstances where the client instructs (without advice) the adviser to acquire a specific product (be it a stock, superannuation or insurance) outside of their normal advice arrangements/agreements. Based on the adviser's knowledge of the client it may be appropriate to do what the client wants without providing advice.

The revised Guide also does not resolve the issue we raised in relation to the original guide, which is that 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 stockbroker to engage in a fact-finding exercise using other possible avenues, to find out what the client did not want to disclose to them. This is another example of the manner in which the emphasis on financial planning in both the Code and the original and revised Guide as well as the lack of recognition of other forms of financial advice, such as stockbroking, continue to present significant challenges to our members.

Standard 3

Standard 3 in the Code has generated the most criticism and the revised Guide does not address the problem with the drafting of the Standard.

FASEA is on the public record as advising that other professions have a similar obligation to avoid conflicts of interest. If we look at the legal profession, while there is a distinction between a law firm's obligation to manage conflicts and an individual lawyers' personal duty to avoid conflicts, the definition of the lawyer's personal duty to avoid conflicts is very narrow. It is the obligation not to give advice to a client which is contrary to the advice provided to another client.

This is very different to the personal duty FASEA imposes on financial advisers to avoid *any* conflict of interest, due to the nature of the financial services industry. The range of circumstances in which an adviser could be called upon to give advice; the range of factors that could potentially be viewed as a conflict (for example, the remuneration model or an interest in the underlying securities such as when a broker provides advice while having a personal holding in the stock); and the fact that the Code is drafted in black and white terms mean that the obligation to avoid any conflict of interest operates fundamentally differently in the financial services profession from how such a duty operates in other professions. The interests of a client must be given priority; however, giving priority to client interests will, on occasion, conflict with personal and other interests.

Avoiding *any* conflict of interest is impossible under the Code, given that the test in Standard 3 has no element of materiality or proportionality. For example, in any payment mechanism (commission, hourly rate, asset-based fee etc), there will be potential conflicts between the interests of the adviser and/or their licensee and the client.

The provisions of the Corporations Act allow for the management of conflicts, not just avoidance. This is included in ASIC's Regulatory Guidance: see for example, RG181 *Managing conflicts of interest,* which provides for three management methods – control; avoid; and disclose (RG181.20). This is repeated in RG175 *Licensing financial product advisers – conduct and disclosure*, which provides that an adviser must prioritise their client's interests (for example, 175.20), and talks of the ability for the conflict to influence the advice in an inappropriate manner

(RG175.64). RG175 also explains the common law position (RG175.90) and the disclosure obligation. The guidance is clear:

> RG 175.404: If an advice provider with a conflict is unable to prioritise the client's interests, they must not provide the advice.

That is, it is only when a client's interests cannot be prioritised that the conflict must be avoided. This is the correct legal position. Every time an adviser is paid (regardless of form), they are potentially conflicted, so for the Code to promulgate that conflicts have to be avoided altogether is clearly unworkable.

We refer to the example in the revised Guide concerning whether it is feasible to provide advice to a couple that is divorcing. If we look at the regulatory guidance, it is clear that if the adviser with a conflict is unable to prioritise the client's interests, they must not provide the advice. Often the interests of a divorcing couple are quite aligned. For example, they may have a jointly-owned SMSF which is being wound up and their interests align. Frequently clients want the same adviser to deal with the matter, yet if the advice has to be split between different advisers it may not be in the client's best interest from the client's perspective. A further problem is that the original guidance states that an adviser cannot provide advice to both parties in a divorcing couple, yet the revised Guide countenances that it is permissible if the interests of each individual are prioritised. Again, we note how important it is for FASEA to clarify if the revised Guide replaces the original guide or works with it. If the original guidance is not withdrawn, it will conflict with the revised Guide.

SAFAA therefore continues to recommend that FASEA revert to the original wording of Standard 3 in the Code of Ethics ('You must not advise, refer or act in any other manner if you would derive inappropriate personal advantage from doing so') 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.

Standard 4

The guidance in relation to standard 4 requires further clarity in relation to existing clients. The revised Guide references a need to collect consent where there is ongoing advice to existing clients and in Fundamental Question 1 it references receipt of an ongoing fee as a requirement for determining which existing clients require consent. That would seem to imply that there is not a requirement to collect consent from existing clients who are not receiving ongoing advice and not paying an ongoing advice fee. This would be the situation for many stockbroking clients who receive point-in-time advice and pay transactional brokerage.

Example 7 answers the question: 'What format is required when obtaining consent from my clients?' as follows.

> An adviser will need to ensure they receive signed consent from their clients. This may be using existing forms e.g. engagement letter, Ongoing Service Agreement, Initial Service Agreement, Authority to Proceed with Advice, etc. For clients that do not have an ongoing service arrangement, eg. Insurance only client the adviser may consider a simple format detailing the conversation and signed by the client.

However, the revised Guide, in the section 'Applying the standard', states:

> You must not proceed to engage the client until you are satisfied you have received informed consent from the client. Following the presentation of advice recommendations, you should not proceed to implement the advice until you are satisfied the client provides informed consent. You may need to use a range of techniques to be satisfied depending on the financial literacy of the client.

This raises the issue as to how an adviser can provide evidence of informed consent if the client signature on a consent form does not suffice. Ultimately a signature should suffice, but if the signature is in a much larger document covering a range of matters, the revised Guide does not clarify if such a signature would mean that consent was not 'free, prior and informed'.

Standard 5

The revised Guide to Standard 5 calls upon advisers to go beyond what is on the licensee's approved product list (APL) if they believe a product outside the APL is in the best interests of the client. SAFAA notes that a licensee has an APL in place to ensure that all products that are recommended meet quality standards. Our concern is that providing guidance to advisers to 'go beyond the APL' means that products could be recommended on which no due diligence has taken place. SAFAA notes that an adviser cannot act outside the scope of their authority.

While the revised Guide notes that the product is not to be recommended if the licensee does not grant approval, we note again that it will be the Courts, AFCA and ASIC that will determine compliance with the Code and an adviser stating that their licensee did not give approval for a product to be recommended is not likely to meet the legal test of the adviser complying with Standard 5.

Standard 6

Standard 6 does not resolve the issue of a financial planning lens being applied to the Code and its guidance, as it assumes all financial advice is the long-term plan that financial planners provide. While the revised Guide recognises that stockbroking is scaled advice, it still requires a stockbroker to consider 'broader long-term interests'. The revised Guide states that a holistic risk assessment is not required for limited scope advice, which indicates that a stockbroker is not required to consider whether the client who wants to buy shares should instead take out a life insurance policy or a term deposit.

SAFAA suggests that 'broader long-term interests' could be contextualised in terms of the weight of a portfolio, or a security's effect on the weight of a portfolio. The appropriateness of advice is generally considered with respect to whether such advice aligns with an individual's risk profile. In this respect, a portfolio can be assessed by determining (irrespective of the potential performance of individual securities) whether the allocation of securities is consistent with an assertive investor, a balanced investor, etc. The weighting of a portfolio would in and of itself be a 'broader long-term interest'; a portfolio's weighting should not be volatile over time – it should remain stable.

However, we note that a client who wants to trade in speculative stocks, or Exchange Traded Options, seeks short-term profits. A client could also want to purchase 1000 BHP shares at a particular price, irrespective of whether it fits the weighting of the portfolio. They do not want consideration of their broader, long-term interests or likely circumstances. While the revised Guide states that scaled advice can be effective in meeting a client's immediate needs, it remains challenging for stockbrokers to provide evidence that they have complied with the Standard, as legal meaning will be given to the Standard (which demands that an adviser must actively consider the client's broader, long-term interests). The current drafting of the Standard 'fits' financial planning, but not scaled advice.

Standard 7

We reference the comments made in relation to Standard 4 and seek further clarity in relation to the requirement to collect Standard 7 consent from existing clients who are receiving point-in-time advice and paying brokerage fees only.

The original Guide references consent being obtained from existing clients as soon as practical after the code commences. The revised Guide now references that the consent is required to be obtained within 12 months. Point-in-time advice referenced earlier and common in the stockbroking industry may mean that a client's need for advice may be infrequent and a financial services firm may not have contact with a client within a 12-month period. The revised Guide references that the precise timetable to collect consent will be influenced by a number of factors including client contact. Therefore, it is inappropriate to reference a fixed timeframe for the collection of consent.

There is also a real question about how advisers can provide evidence that fees and charges are 'fair and reasonable and represent value for money to the client', as stated in the revised Guide.

Many different fee-charging models exist. The revised Guide states that you may consider for example the quantum and complexity of services you provide to each client, the level of ongoing advice you provide, what value you are adding to the client and how the amount you charge the client reflects that service and value.

All licensees will assess this differently, because they will all need to consider their cost base.

Standard 8

SAFAA has no comment on Standard 8.

Standards 9 and 10

Standards 9 and 10 in the Code repeat the legislative provisions in the Corporations Act on having a reasonable basis (section 945A(1)) and making reasonable investigations (section 961B(2)(e)(i)) for any personal advice given. While Standard 1 requires advisers to comply with the law, we note that reference to legal obligations is referenced at some points in the revised Guide, but not others. There should be a reference to the legal obligations in the guidance to the Code with confirmation that the ethical and legal obligations need to be considered together.

Standard 9 provides a listed of questions that could be asked in considering whether the requirements of the standard have been met. While the revised Guide notes that the questions 'may be considered', SAFAA is concerned that the list becomes another set of questions that demand evidence of having been met in order to prove that an adviser has met the Standard.

In Standard 10, the 40 CPD hours per year do not provide sufficient flexibility to accommodate diversity and health considerations (for example, maternity leave, sick leave etc where a person takes extended leave). This also applies to instances where advisers are supervising those in training. Recognition of the impact of these matters needs to be included in the guidance.

Standard 11

SAFAA has no comment on Standard 11.

Standard 12
Standard 12 raises the issue that advice is subjective and advisers will not all give the same advice, so challenging other advisers if you disagree with their advice is problematic. An adviser may challenge another adviser on the basis that they have not met the 'values' of the Code, when in fact they simply disagree with the advice provided, as they made a different judgment.

Again, we note that the Courts and ASIC will interpret compliance with the Code.

CONCLUSION

SAFAA notes that there is reference to a 'transition' period for some of the items. Given we are nearly 12 months into the new regime and the fact that we now have the revised Guide on applying / complying with the standards, FASEA needs to issue clear communication about the implementation expectations.

Importantly, legislation arising from Royal Commission recommendations is expected soon, which will include provisions covering fee disclosure and ongoing fee arrangements. The revised Guide introduces duplication of the forthcoming legislation on these matters. As we do not yet know the final form of the legislation, any guidance from FASEA on these matters and expectation of implementation should wait until the final form of the legislation is known.

SAFAA appreciates the opportunity to provide feedback on the revised Guide. We have relied on the important contribution from our Member firms, who are in the process of reviewing the Guide as it applies to their businesses.

Yours sincerely

Judith Fox
Chief Executive Officer