

29 November 2021

Email: amelia.constantinidis@fasea.gov.au

Amelia Constantinidis
Standards Director
Financial Adviser Standards and Ethics Authority Ltd
PO Box A255
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Dear Amelia

CODE OF ETHICS —CONSULTATION ON STANDARD 3

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 that 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.

Thank you for the opportunity to provide feedback on options on potential amendment to the wording of Standard 3 to reflect the intention of the Standard. SAFAA has long expressed concern about the wording of Standard 3 and sought its revision. In our submission of 2 November 2020 to the FASEA consultation on the revised *Financial Planners & Advisers Code of Ethics 2019 Guide* (the revised Guide October 2020), SAFAA noted that the focus of most concern remained Standard 3 in the Code of Ethics. We are therefore very pleased to see FASEA consult on options for changing the wording of Standard 3.

We have also taken the opportunity to provide feedback on Standard 6 and the guidance to the Code.

Standard 3

In our 2 November 2020 submission, we noted that Standard 3 had 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'.

We noted that 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 also recommended that Standard 3 should utilise the wording of the Intent of Standard 3, so that the Standard would state:

'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.'

Our comments on the options provided for consultation follow.

Option 1: You must only advise, refer or act where you do not have a conflict of interest or duty, being that which could reasonably be expected to induce you to act other than in the client's best interest.

In line with our November 2020 submission, we consider Option 1 is the best choice of the three presented.

However, we still prefer our previous recommended wording utilising the wording in the intent, as drafted by FASEA. We consider the wording *'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.'* is simpler and easier to understand than the proposed wording in Option 1. Our view is that the wording should be as clear and direct as possible — criteria not met by the proposed wording.

The wording of *'you must not'* is a simpler concept to understand than *'you must only'*. Additionally, our suggested wording of *'that is contrary to the client's best interests'* is much easier to understand, simpler and more direct than your suggested wording of *'being that which could induce you to act other than in the client's best interest.'*

SAFAA recommends FASEA use Option 1, but also recommends that the wording be made clearer and more accessible by utilising the wording in the intent *'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.'*

Option 2: You must not receive any benefit (whether monetary or non-monetary), nor enter into any relationship, that could reasonably be expected to influence the advice you give or the service you provide to your client.

While we note that FASEA includes the note with this option that it is in line with Commissioner Hayne's findings, we cannot support Option 2, as it again shows a lack of understanding about the operation of stockbroking and investment advice.

Stockbrokers and investment advisers have relationships with research analysts, who provide research reports on listed equities. Research reports are valued by clients, as they assist them to determine both the state of their current investments and investment opportunities. That is, research reports are an essential input to investment advice.

A lack of information creates inefficiencies that result in stocks being misrepresented (whether over or undervalued). The role of equity research is to provide information to the market. In an equity research report, an analyst lays out their recommendation, target price, investment thesis, valuation, and risks. The report is produced by research analysts with deep expertise about companies and sectors and is valuable intellectual property.

The wording of Option 2 would prevent stockbrokers and investment advisers having any relationship with research analysts or receiving reports from them or distributing them to retail clients. This would be to the

severe detriment of retail investors, who would be deprived of essential research on their current investments and investment opportunities.

Addressing the Stockbrokers and Financial Advisers Association virtual conference in August 2020, Ashurst partner Jonathan Gordon said the 'black and white terms' in which the FASEA Code has been drafted meant its standards could be strictly enforced by the courts regardless of FASEA's guidance on how to interpret them. For this reason, despite any guidance from FASEA, the wording of Option 2 would have a deleterious impact on the capacity of retail investors to access quality research on listed equities.

Option 3: Status quo

As we have noted in multiple submissions, avoiding any conflict of interest is impossible under the Code, given that the test in Standard 3 has no element of materiality or proportionality.

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. The correct legal and ethical position is that it is only when a client's interests cannot be prioritised that the conflict must be avoided.

A stockbroker may own shares in a stock being recommended to a client. This is because the stockbroker sees a valuable investment opportunity in the stock, from which the client will benefit. The stockbroker has 'skin in the game', which in all other contexts is considered an alignment of interests, but which under the current wording of Standard 3 would be considered a conflict of interest.

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, ASIC and the Single Disciplinary Body (the Financial Services and Credit Panel) 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.

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 repeat our view that the current wording of Standard 3 therefore is unworkable and does not help achieve the outcome that FASEA is seeking and which we support, which is enhanced professional standards.

Standard 6

Standard 6 of the Code is an impediment to the provision of scaled or limited advice. SAFAA has long argued that this standard conflicts with the provision of limited advice and is inconsistent with section 961B of the Corporations Act.

Continuation of Standard 6 in its current form will also defeat any efforts by ASIC to provide meaningful guidance on scaled advice.

Stockbroking involves the provision of scaled advice hundreds of times a day. A client may want to purchase 1000 BHP shares at a particular price, irrespective of whether it fits the weighting of the portfolio, or a client may want to trade in speculative stocks, or Exchange Traded Options, seeking short-term profits. They do not want consideration of their broader, long-term interests or likely circumstances. Standard 6 is tailored to the need to consider a client's long-term interests and circumstances as required in financial planning, but does not accommodate clients wanting to access scaled advice.

While this standard remains unchanged, advisers providing scaled advice risk being found to be in breach of the standard by failing to take into account a client's broader, long-term interests and likely circumstances. This issue has greater urgency as a result of the introduction of the Single Disciplinary Body on 1 January 2022.

Accordingly, SAFAA recommends that Standard 6 be removed from the Code.

Guidance to the Code

FASEA has issued two versions of guidance to the code for consultation (one issued in October 2019 and one issued in October 2020), as well as its response to consultation on the 2019 guidance. SAFAA has provided feedback to FASEA about both versions of the guidance. FASEA has not explicitly advised whether the revised Guide released in October 2020 replaces the 2019 guidance, or whether the revised Guide released in October 2020 is the final version, or whether the two Guides are meant to work together, or whether additional changes will be made to take into account feedback received as a result of the October 2020 consultation.

As a result there is an accumulation of guidance, which at times is conflicting. The confusion remains. SAFAA recommends that FASEA issue a notice withdrawing the original guidance issued in 2019 — and its response to that guidance — and clarify that the revised Guide issued in October 2020 is the sole version of guidance which should be referenced. We note that the Guide issued in October 2020 will need to be further revised following this consultation and recommend strongly that FASEA clarify that the third guidance constitutes the sole guidance. As the Single Disciplinary Body is due to commence on 1 January 2022, clarity and certainty as to which guidance the body should reference is essential.

Kind regards

A handwritten signature in black ink, appearing to be 'JF' with a large flourish and '6x' written below it.

Judith Fox
Chief Executive Officer