FSC FINANCIAL SERVICES COUNCIL

20 December 2018

Stephen Glenfield
Chief Executive Officer
Financial Adviser Standards and Ethics Authority
Sydney NSW 2000

BY EMAIL: consultation@fasea.gov.au / Stephen.Glenfield@fasea.gov.au

Dear Mr Glenfield,

RE: FASEA Legislative Instrument and Explanatory Statement: Code of Ethics

The Financial Services Council (**FSC**) is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in Australia's largest industry sector, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing almost $3 trillion on behalf of more than 14.8 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

We welcome the opportunity to make a submission to the Financial Adviser Standards and Ethics Authority (**FASEA**).

Should you wish to discuss this submission further please do not hesitate to contact me on (02) 9299 3022.

Yours sincerely

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FASEA LEGISLATIVE INSTRUMENT AND EXPLANATORY STATEMENT: CODE OF ETHICS

Generally

The FSC and its members support the proposed *Financial Planners and Advisers Code of Ethics 2018*. We believe the financial advice industry's commitment to a Code of Ethics will have the effect of increasing consumer trust and confidence in the industry.

As described in the draft Legislative Instrument, it is important for financial advisers and planners (referred to throughout as "relevant providers") to provide a commercial service, while at the same time committing to providing a professional service. We believe relevant providers can do both (and therefore consider the wording in the fifth paragraph under *5 The Values and the Standards* should be reconsidered). We see this Code of Ethics as underpinning that professional service.

To assist FASEA in this regard, we make the comments as set out herein.

As a general comment, it appears that at least four of the proposed Standards either have the intention (or in any event the impact) of extending existing legal obligations under the Corporations Act, specifically:

- section 961B, the Best Interest Duty, to clients who have not received personal advice (Standards 2 and 6); and
- section 962K, the obligation to provide Renewal Notices, to clients who received personal advice from the adviser before 1 July 2013 (Standards 4 and 7).

Given the possible significant ramifications of these extensions, we suggest that FASEA conducts a regulatory impact assessment in relation to the impact of such extensions, if it has not already done so.

Commencement Date

Section 2 of the draft Legislative Instrument states that the Code of Ethics commences 30 days after it is registered. This conflicts with transitional arrangements under section 1546F of the Corporations Act which provides that compliance with the Code of Ethics is required from 1 January 2020.

We also note that there is a reference in paragraphs 43 and 53 of the draft Explanatory Statement to the commencement date as set out in *section 3* of the Code. We believe that these should be references to section 2 of the Code of Ethics.

Standard 2

The draft Legislative Instrument states:

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

We submit that the Explanatory Statement incorrectly states that section 961B of the Corporations Act, together with sections 961C, 961D and 961E, require that a relevant provider:

"identifies and completes any reasonably apparent gaps in the [client's] information".

The Corporations Act requires a relevant provider to:

- make reasonable inquiries to obtain complete and accurate information where it is reasonably apparent that information relating to the client's circumstances is incomplete or inaccurate (section 961B(c)); and
- warn the client that the advice is based on incomplete or inaccurate information, if it is reasonably apparent that information relating to the client's objectives, financial situation and needs on which the advice is based is incomplete or inaccurate.

We believe that the Corporations Act has been drafted in this manner in recognition that clients may not always be willing or able to provide all relevant information.

Further, we are concerned about the expectation in the Explanatory Statement that advisers should consider the future circumstances of their client and their client's family. Such an obligation could result in an absurd occurrence whereby the relevant provider is gathering information from a third party (that is, his/her client) relating to people who he/she has never met and has no direct obligation; and using that information to provide advice to his/her client. The possibility of making inaccurate assumptions in these circumstances is high. While we agree that the relevant provider should attempt to consider the client's future circumstances, the example provided is problematic.

Additionally, regarding the client's future circumstances, it ought be made clear from the Explanatory Statement that the relevant provider should consider the client's future circumstances with the client. The current wording appears to read as if the adviser were obliged to ascertain on his/her own what the client's future circumstances may be. It would be very concerning if a relevant provider assumed that he/she knew more about the client's "likely future circumstances" than the client does.

Recommendation 1: That FASEA recognises that clients may choose not to provide to the relevant provider the information required to accurately determine their objectives, financial situation and needs or their future circumstances, and that the warning provided for under s961H of the Act may be more appropriate. Alternatively, the matters referred to in paragraphs 31 and 32 of the Explanatory Statement ought be on a "best endeavours" basis only.

Further, much of the language in paragraphs 31 and 32 is not appropriate where the client has specifically requested scaled advice only.

Recommendation 2: That paragraphs 31 and 32 specifically state that they do not apply where the client has requested scaled advice only.

We also reiterate our comments under *Generally* in this submission to the effect that Standard 2 extends the Best Interest Duty to clients who have not been provided with personal advice.

Recommendation 3: That a relevant provider only be obliged to act in the best interests of the client to whom he/she is providing personal advice (as per section 961B).

Standard 3

The draft Legislative Instrument states:

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

The Explanatory Statement uses an example where an adviser, Sally, has two clients, Bill and Ben. The Explanatory Statement states that if Sally's duty to Bill conflicts with her duty to Ben and that she receives a benefit from either, this would be inappropriate.

We suggest the example requires more detail to be useful. That detail could include for example, the reasons why Sally's duty to Bill conflicts with her duty to Ben, and the types of benefits that Sally would receive which could be inappropriate. We also consider that it would be of assistance to provide a range of actions that Sally could undertake to ensure she does not obtain advantage inappropriately from such a situation.

Recommendation 4: That the example referred to above include more detail.

Standard 4

The draft Legislative Instrument states:

> "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."

In relation to clients with whom the relevant provider has entered into an ongoing fee arrangement (**OFA**), the provider must:

- "opt-in" those clients whose OFA commenced on or after 1 July 2013 to continue to receive services every two years; and
- give them a Fee Disclosure Statement annually.

Given the existence of these client protections, FSC members believe relevant providers should only be obliged to obtain informed consent from existing clients at the time they provide any additional service to these clients. This should also be the case for clients in relation to whom the relevant provider does not have an OFA as these clients are not receiving an ongoing service, therefore ongoing consent is not required.

Recommendation 5: That Standard 4 not be applied retrospectively to existing clients.

Standard 5

The draft Legislative Instrument states:

> "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."

FSC members are unsure of the potential responsibilities relevant providers would face if they were obliged to have "reasonable grounds to be satisfied". We believe FASEA could better assist relevant providers by defining what level or standard a relevant provider must reach to have reasonable grounds to be satisfied that clients understand the advice, benefits, costs and risks associated with the recommended financial products.

Further, FSC members seek clarification as to whether Standard 5 requires licensees to modify existing advice documents (for example by creating a new 'Declaration' page in the Statement of Advice (**SOA**)) or relevant providers to make a file note so that they are able to demonstrate that they had reasonable grounds to be satisfied.

Recommendation 6: That FASEA clarifies the steps or processes which advisers must meet to be satisfied on reasonable grounds that their advice is understood by their clients.

Standard 6 – Best Interest Duty

The draft Legislative Instrument states:

> "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."

The FSC believes this amendment broadens the Best Interests Duty under section 961B in that it obliges the relevant provider to consider matters not directly related to the client when providing advice to the client. While the FSC does not take issue with the intent behind Standard 6, we consider that the wording used in the Explanatory Statement is unsatisfactory. The Explanatory Statement's commentary that the relevant provider must take into account the implications of his/her advice on the client's family members is problematic. We submit that this would create a significant degree of uncertainty in considering the needs and objectives of others with whom the relevant provider has no direct relationship or connection. The relevant provider would have to base his/her advice on what the client assumes to be the needs and objectives of any other affected people. Further, the FSC considers that such an analysis may not necessarily place the client in a better position. In fact, it may place the client in a worse situation.

Additionally, the Explanatory Statement appears to suggest that, when giving advice to a client (the **First Client**) a relevant provider owes a duty to act in the best interests:

- of another person (the **Second Client**) who is also a client of the relevant provider, when giving advice to the First Client. An example could be where the relevant provider acts separately for the parents and a child of a family. Should the couple instruct the relevant provider that they do not want to leave an inheritance to the child, the Explanatory Statement appears to suggest that by carrying out the parents' instructions, the relevant provider would be in breach of the Code of Ethics as this would not be in their best interests of the child; and
- of a person who is a client of another relevant provider under the same principal (the **Second Client**).

The obligations in section 961B only extent to the client of the relevant provider to whom he/she is providing personal advice at that time, and not to the Second Clients.

We consider extending the reach of the Best Interest Duty in the manner envisaged in the Explanatory Statement may create the situation where the First Client's objectives, financial situation and needs are compromised because the relevant provider is considering the competing interests of the Second Clients. We therefore suggest that FASEA revisits the wording and examples contained in Standard 6 of the Explanatory Statement so that their application does not result in unforeseen consequences.

Recommendation 7: That a relevant provider only be obliged to act in the best interests of the client to whom he/she is providing advice (as per section 961B). The wording and examples in the Explanatory Statement be revisited.

Standard 7

The draft Legislative Standard states:

> "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."

We reiterate our comments in relation to Standard 4 above, that the Code of Ethics should not apply retrospectively. Benefits currently received have been disclosed to clients in the Financial Services Guide, which clients usually receive at the same time as the Statement of Advice (which clients generally sign).

Recommendation 8: That Standard 7 not be applied retrospectively to existing clients.

We also question the broad nature of the term 'third party' and submit that this rule should not apply to third parties funding the client to receive advice from the relevant provider.

FSC members query the types of non-monetary benefits that are required to be disclosed and that require client consent.

Recommendation 9: FASEA provides further context on the types of non-monetary benefits that are required to be disclosed and require client consent.

Further, FSC members are concerned about the obligation to ensure adviser's fees are "fair and reasonable and represent value for money".

We submit that whether the fee for a service is "value for money" is a subjective test, based on an individual's opinion of the utility of the service they receive. Such an opinion may increase or decrease with the value of any investments a relevant provider has recommended the client acquire.

We also question the process relevant providers would need to adopt to implement such a standard. For example, we ask whether FASEA considers that this is a matter which could be included in the 'Declaration' in the SOA, wherein the client ticks a box next to a sentence stating "I agree that I have received value for money"

Recommendation 10: That FASEA considers implementing an objective test with clear criteria to determine whether adviser's fees are "value for money".

Standard 9

The draft Legislative Instrument states:

> "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."

The FSC agrees that relevant providers must provide advice and recommend products in good faith and with competence. However, while a relevant provider must take responsibility for the advice they provide, the provision of this advice is based on some variables which the individual relevant provider cannot control. One such variable is the product's Product Disclosure Statement (**PDS**) which is written by the issuer. While the relevant provider can ensure he/she only recommends products of high quality which he/she believes is in the best interests of the client, the relevant provider is unable to ensure the contents of the PDS or other material received from the issuer are not misleading or deceptive.

Recommendation 11: That FASEA amends Standard 9 to read:

> *All advice you give, and all products you recommend, to a client must:*
>
> *a) be offered in good faith and with competence;*
> *b) be based on information that, as far as the relevant provider is aware, acting reasonably, is neither misleading nor deceptive.*