



FINANCIAL
SERVICES
COUNCIL

FASEA Consultation on Standard 3 of the Code of Ethics

FSC Submission

December 2021



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1. About the Financial Services Council

The FSC is a leading industry body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advice licensees 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 \$3 trillion on behalf of more than 15.6 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.

2. Executive Summary

The FSC welcomes the opportunity to submit to *FASEA Consultation – Financial Planners & Advisers Code of Ethics 2019 – Standard 3*.

Standard 3, as currently worded, and the Guidance to support its interpretation, is contradictory. This has resulted in confusion about its application to the provision of financial advice.

How to act where a conflict arises is separate from determining *what* activity or act constitutes a conflict. While Standard 3 is clear that where there is a conflict an adviser must not act, it is not clear in what situations a conflict *exists* that would trigger the obligation on the adviser to act or not act. For example, the current wording of Standard 3 makes clear that where an adviser has a conflict they must not act, and a supporting Explanatory Memorandum further underlines this. However, what activity exactly constitutes a conflict, and the Guidance to support Standard 3 does not clarify what activity or situations are a conflict. A secondary issue has arisen as to the weight provided to the Guidance in interpreting Standard 3.

The FSC recommends:

- Adoption of Option 1 with revised wording to better reflect the overall intent of the Standard and better practical application which states: *You must only advise, refer or act where you do not have an actual conflict of interest or duty, being that which is reasonably likely to induce you to act other than in the client's interest.*
- Consolidation of all Guidance of the Code of Ethics into a single document that is updated as needed, and the guidance relating to Standard 3 updated should the wording of Standard 3 change
- Wherever possible all forms of remuneration and activity permitted and not permitted under Standard 3 be clarified
- Define reasonableness for the purposes of ensuring a clearer standard

While improvements to Standard 3 can be made in isolation of changes to the remaining standards, this change alone will not sufficiently position the Code as a principles-based instrument overall. The FSC advocates that the Code of Ethics should be revised following the abolition of the safe harbour steps to support a coherent principles-based regulatory regime for meeting obligations as such as the Best Interests Duty in the Corporations Act 2001 (“**the Act**”).¹

¹ White Paper on financial advice: <https://fsc.org.au/policy/advice/white-paper-advice>

3. Preferred option

The FSC supports Option 1 subject to certain amendments. (See *Alternative wording*).

Option 1 avoids unnecessary focus on general conflicts as opposed to management of conflicts and offers a stronger statutory footing on which more consistent guidance can be based. This wording provides a more certain foundation, allowing the Guidance to clarify acts or omissions during the advice process that could be reasonably considered to fall, or not fall, within the realm of a conflict for the purposes of Standard 3. This provides a more practical, principles-based regulatory tool by which to compel professional, consistent and compliant financial advice.

By contrast, Option 2's wording would inhibit the ability to form relationships with other service providers, including those relationships which did not involve the payment of referral fees. On its face, it would prevent relationships:

- which provide a benefit to clients (but none to the adviser), which would induce the adviser to act in the client's interest to secure that benefit; and
- between advisers and other professionals, which would result in advisers being prevented from helping their client, for example, by referring them to a lawyer or an accountant.

4. Alternative wording

Recommendation

Standard 3 should be amended to read:

You must only advise, refer or act where you do not have an actual conflict of interest or duty, being that which is reasonably likely to induce you to act other than in the client's interest.

Revised guidance should be issued to support this new wording.

This wording provides a more certain foundation, allowing the Guidance to clarify acts or omissions within the advice process that could be reasonably considered to fall or not fall within the realm of a conflict, for the purposes of Standard 3. This provides a more practical, principles-based regulatory tool by which to compel professional, consistent and compliant financial advice.

The FSC's proposed wording is consistent with industry's current interpretation as informed by the additional guidance FASEA have released.

- **"Actual conflicts"**: Given FASEA intends for Standard 3 to apply only to *actual* conflicts of interest, this should be made explicit in the wording of the standard itself. Such wording makes clear that the intent of Standard 3 is not to avoid 'all' possible conflicts of interests but only those that actually exist. FASEA states in its Guidance dated October 2020 that:

"Standard 3 of the Code is concerned with an actual conflict ...".²

This should be stated in the standard, with a clear definition of 'actual conflict of interest' (eg actual conflict of interest is a conflict of interest that has not been properly managed, could reasonably be expected to motivate the advice that's not in the best interests of the client and/or induce the adviser to put their own or other's interests before their client's).

- **"Client's interests"**: The requirement for the adviser to act in the client's interests aligns with the obligation set out in Section 961J of the Act, which imposes a duty on an advice provider to prioritise the interests of their client in the event of a conflict of interest. Conversely, the language of 'best interests' suggests a link with duty to act in the client's best interests under Section 961B of the Act. This duty is concerned more with the process followed in advising the client, rather than the outcome. Standard 3 by contrast relates to outcomes. For example, if there is an actual conflict of interest, that will prevent an advice provider from acting in a client's interests or prioritising their interests over their own, or those of a related party, then they must not act.

² Page 17. 'Financial Planners & Advisers Code of Ethics 2019 Guide – October 2020' (Source: <https://www.fasea.gov.au/wp-content/uploads/2020/10/Financial-Planners-and-Advisers-Code-of-Ethics-2020-Guide.pdf>)

- **“Reasonably likely to”:** “Replacing the words “*could reasonably be expected to*” with ‘*reasonably likely to*’ is consistent with the intent of the standard to apply to actual conflicts only. Furthermore, this wording introduces an element of materiality to the assessment of the conflict. It is important for the wording of the standard to be clear that it is not intending to capture immaterial conflicts of interest which are unlikely to influence adviser conduct.
 - For example, an adviser who recommends that a client invests in a managed portfolio that includes shares which are also held by the adviser is an immaterial conflict that can be effectively managed by the adviser.
 - Another example is an adviser who works in a multi-disciplinary practice. Under the current wording, this structure could prevent the adviser from referring a client to the mortgage broking arm of the group. The proposed wording suggests that there must be a real, not a remote or fanciful chance, that the actual conflict of interest will induce the adviser to act other than in the client’s interests. This is a more practical standard, as it allows the benefits to clients of these practice structures to be realised.

Standard of judgement and reasonableness

FASEA’s current guidance provides no measure of materiality. The introduction of the word ‘reasonably’ is an improvement. It is not clear how judicious the term ‘reasonably’ is intended.

FASEA have outlined a ‘standard of judgement test’ which is complex in itself – incorporating an ‘unbiased person’, a ‘reasonable person’, an ‘ordinary person’ and a ‘disinterested person’ which should be clarified. The ‘standard of judgement’ reasonable test in the Guidance should be reflected in the Code to allow the flexibility in looking at the materiality of a conflict of interests.

Recommendation

The standard of judgement should be simplified and ‘reasonableness’ defined in the Guidance for the purposes of Standard 3 of the Code of Ethics.

5. Practical application

To support the alternative wording, improved direction will be required in the following areas outlined below. This will alleviate the current uncertainty regarding the meaning and application of Standard 3.

Need for a single document

Recommendation

All Guidance pertaining to the Code should be consolidated into a single document that is updated and consulted on.

There have been several iterations of Guidance in relation to the Code of Ethics issued by FASEA over the past several years. As the industry evolves it can be expected revisions will be necessary in future, to avoid confusion and ensure clarity. This should take the form of revisions to a single set of guidance that is updated as opposed to announcements of in effect, additional guidance on specific issues.

The single document might also clarify confusion around the various iterations of the Guidance issued by FASEA in previous years as summarised below:

- a. FG002 Financial Planners and Advisers Code of Ethics 2019 Guidance issued in October 2019
- b. Preliminary Response to submissions on FG002 document issued in December 2019
- c. Financial Planners & Advisers Code of Ethics 2019 (the Guide) issued in October 2020

These documents comprise 90 pages of direction with morphing positions on certain elements of the Code. We note that FASEA's further guidance document provided on 5 October 2020 (the Financial Planners and Advisers Code of Ethics Guide 2019) was open for consultation until 2 November 2020. No feedback or response from FASEA in relation to this consultation has been issued.

Specifying permissible forms of remuneration

Recommendation

Guidance should include a statement of what specific forms of remuneration and or activity will or will not meet Standard 3 in all situations.

FASEA states that:

“The Code does not seek to ban particular forms of remuneration, nor does it determine that particular forms of remuneration will always give rise to an actual conflict of interest or duty. That said, advice provision should remain open to the

possibility that certain forms of remuneration will always fail to meet the requirements of the Code of Ethics”³.

The last sentence contradicts the first sentence. FASEA should define what these forms of remuneration are to provide certainty to an advice provider that in collection remuneration for certain forms of advice they are complying with Standard 3. It is not unreasonable for the Standard-setter to instead specify which forms of remuneration are or are not permissible. There will be certain context-dependent situations where such remuneration cannot be defined in the Guidance but where it can be it should be listed.

³ Page 17. ‘Financial Planners & Advisers Code of Ethics 2019 Guide – October 2020’ (Source: <https://www.fasea.gov.au/wp-content/uploads/2020/10/Financial-Planners-and-Advisers-Code-of-Ethics-2020-Guide.pdf>)