From the Desk of Director Marija Pajeska

30 May 2018

Financial Adviser Standards and Ethics Authority

By email: consultation@fasea.gov.au

Response to FASEA Consultation – Code of Ethics for Financial Advisers (Exposure Draft of Proposed Standard)

The Association of Securities and Derivatives Advisers of Australia (ASDAA) appreciates the opportunity to provide these comments to FASEA in respect of FASEA Consultation Paper – Code of Ethics for Financial Advisers (Exposure Draft of Proposed Standard).

ASDAA's members are comprised of individuals who are either directors or employees of firms which hold Australian Financial Services Licences (AFSLs).

We provide the following comments with regards to the wording of the draft FASEA Code of Ethics:

- We refer to the first paragraph in the preamble of the draft FASEA Code of Ethics, i.e.

  > 'While the ethos of 'the market' legitimises the pursuit of self-interest through the satisfaction of others' wants, the ethos of 'the professions' aims to secure the public good through the subordination of self-interest in favour of serving the interests of others.'

  We refer to Standard 5(c) which expects that all advice and products be presented in terms easily understood by the client.

  It's interesting that FASEA has opted to use such technical jargon in the opening paragraph of the draft Code of Ethics.

  It is our understanding that the Code of Ethics is to set the standard under which the industry should provide its services and technical provides an example of the terms and language that should be used.

  It is also our understanding that the Code of Ethics is to be a document that clients can have access to, so as to determine whether their adviser has acted in a manner that is Ethical.

Most clients would not bother reading beyond the first paragraph on the basis that the first paragraph is pure technical jargon and makes no sense to them. It appears that FASEA is proposing to breach its own code by using language and terms which are not easily understood by a client and in doing so is promoting the use of technical jargon thus encouraging advisers to breach the code.

- We refer to the following statement used in the second paragraph of the preamble of the draft FASEA Code of Ethics

  '…formal and informal privileges (such as a 'monopoly' right to undertake certain types of work[1])'

  We note the '1' next to work refers to a footnote that explains the use of the term 'financial planner' and 'financial adviser'.

  We feel that describing the work undertaking by an adviser as a monopoly right is inappropriate, misleading and deceptive.

  A monopoly by definition (based on English Oxford Dictionary) is a company or group having exclusive control over a commodity or service.

  There is no one adviser or group of advisers that have exclusive control over the provision of advice to clients.

  In fact the provision of advice to clients comes in many forms, business models, business structures, formats, etc.

  Examples of the different services provided include financial planners, wealth management, providers of personal advice in superannuation, personal advice provided to those who trade financial markets, MDA Services, etc.

  It is misleading and deceptive to suggest that all advice providers work together and/ or collude when providing services to their clients.

  The wording in the brackets should be removed.

- Standard 2 states 'Must neither advise, refer, nor act in any other manner, where inappropriate personal advantage is derived by the relevant provider.'

  We understand that the objective of this standard is to ensure that conflicts of interest (especially those related to conflicted remuneration) are managed appropriately.

  Most advisers either operate their own financial services business or are employees of a financial services provider whereby they are paid a salary plus commission.

  So in providing services to their clients, most advisers will have a personal advantage. It is effectively the way they generate income and are rewarded for the work they do. To be paid for work is an adviser's legal right.

At times advisers may receive other benefits which could be deemed a personal advantage, such as access to seminars held by a product issuer/ other third party or access to conferences or road shows sponsored by a product issuer/ other third party. These may be provided to an adviser free of charge.

The Code of Ethics should not limit the adviser's legal rights to financial entitlements (i.e. income and benefits) resulting from work performed.

- Standard 2 gives rise to the question of what is considered inappropriate. By definition inappropriate is something that is not suitable or proper in the circumstances.

  Taking into consideration the diversity of business models used by advisers whilst providing advice to clients it will be difficult to define 'inappropriate personal advantage' without creating an issue whereby you are limiting and/ or interfering with an adviser's legal rights.

- Standard 2 provides an opportunity for a client to claim that an adviser received 'inappropriate personal advantage' after the services were delivered even though the client may have had a full understanding of the services to be provided and was more than willing to engage the adviser.

  We need to be careful to ensure that the Code of Ethics is not drafted with the assumption that all advisers act to the detriment of clients and that all clients are innocent and are a target to be taken advantage of.

  Reality is that there are persons, who become clients, who are more than willing to take a gamble and then claim that they were an innocent victim when things don't go according to plan.

- We are of the view that the wording should be changed to:

  > 'Must neither advise, refer, nor act in any other manner, where a conflict of interest is derived by the relevant provider'

  The use of the term conflict of interest is more appropriate as it supports an existing legal framework, that is:

  - the statutory obligation to manage conflicts of interest in Section 912A(1)(aa); and
  - ASIC Regulatory Guide RG181 – Licensing: Managing conflicts of interest

  It also captures other scenarios where the adviser may not necessarily gain a personal advantage however may still be engaging in conduct which is to the detriment of the client or potentially conduct that is to the advantage of the client (such as insider trading) however to the detriment of industry and the market in general.

- We note that in Standard 3, FASEA proposes to use the wording 'independently minded professional'.

In ASIC Regulatory Guide RG175, ASIC has stated that words such as 'independent', 'impartial' and 'unbiased' are restricted words and cannot be used by a financial services business or in the provision of a financial service where, in summary:

- commissions, volume-based payments or other gifts or benefits are received;
- where the financial service provider operates under direct or indirect restrictions relating to the financial products in respect to which financial services are provided; or
- where conflicts of interest may arise from any relationships with product issuers which may reasonably influence the person.

We have no objection with the intent of the use of the words 'independently minded person' however have concerns with the use of the word independent on the basis that it is a restricted word.

Therefore, it appears that Standard 3 would be promoting advisers to refer to themselves as independently minded persons and whilst doing so they would be inadvertently breaching the law as they are not permitted to use the word independent as it is a restricted word.

- Standard 4 includes the wording 'free, prior and informed consent of a client'.

  Under an MDA Service, the MDA provider (or its nominated representative) has the discretion to invest in financial products using client contributions without prior reference to the client for each transaction, subject to any limitation that may be agreed between the client and the MDA provider.

  Within an MDA Service, the adviser must provide personal advice to a client regarding the basis on which the MDA contract is considered to be suitable for the client and whether the range of investments offered through the MDA are appropriate for the client.

  Further clarity would need to be provided with regards to the Standard 4 and its interaction with the provision of advice under an MDA Service as clients will not be consenting or be informed of each transaction prior to its execution.

  This may be achieved by amending the wording to 'Act on the recommended advice on the basis of the free, prior and informed consent of a client.'

- Standard 5(c) requires all advice and products to be presented in terms easily understood by the client.

  We note that the Product Disclosure Statement (PDS) is created by the product issuer. In creating the PDS the product issuer has certain standards that it must comply with, which may or may not be consistent with Standard 5. In most circumstances the product issuer has no obligation to meet the requirements of the FASEA Code of Ethics as it is not an adviser by definition.

  In general, an adviser will provide the PDS to a client, which is the document that explains the product being offered. The adviser has no input or control over the information included in the PDS and therefore should bear no

responsibility (actual or assumed) to ensure that the information included in the PDS meets the requirements of Standard 5.

We need to be mindful of the fact that clients are inundated with documentation when they receive a financial service and/ or financial product advice. The last thing FASEA should be seeking to do is give clients more paperwork which the client is not likely to read and may result in the provision of conflicted information being provided to a client as documents issued by an adviser contain information which is not consistent to the information included in a PDS.

- Standard 8 requires an adviser to obtain informed consent, and agree to maintain records relevant to the advice provided, in accordance with relevant privacy, regulatory and confidentiality obligations.

  The law requires an adviser to maintain records. Examples of some of the requirements are:

  - Pursuant to ASIC Class Order [CO 14/923] and Section 912G of the Corporations Act 2001 and AFS Licensee has an obligation to maintain a record of the information it relied on and the action taken by the provider that indicates that the provider has acted in the best interest of the client.
  - Pursuant to Section 991D of the Corporations Act 2001 and Regulation 7.8.19 of the Corporations Regulations 2001 an AFS Licensee must keep records in relation to instructions received from clients.
  - Under RG165 the licensee has an obligation to maintain records of a complaint which would contain records relating to services provided to a client.
  - Under the AMLCTF Act the designated service provider is required to maintain records relating to the identity of the client.

  In most instances the requirement is to maintain the record for seven (7) years and in some instances it is for seven (7) years after the advice is provided.

  The Statement of Advice is a record of the client's information and the acknowledgment included within the Statement of Advice (SoA), i.e. the Authority to Proceed, is the document that the client will sign to provide the consent and agreement to the maintenance of records. This is illogical as the adviser has already created a record by compiling the SoA.

  The law is not subject to obtaining consent from a client and therefore this standard implies that an adviser should breach the law should the client not provide its informed consent and agree that the adviser may keep records.

  We assume that this is not the intent of Standard 8 and recommend that it be amended to ensure the ongoing compliance by an adviser with its legal obligation to maintain records.

- Standard 10 refers to the knowledge and skills to be acquired by a relevant provider. As FASEA is responsible for setting the educational standards then it would be more practical to redraft this standard to make reference to the Educational and Training Standards defined by FASEA.

Our comments on FASEA's request to Feedback on pathways:

1. How the Code addresses the consumer detriments that have arisen in financial advice, particularly Standard 2, which is intended to ensure that the advice (or referral or other service) that a consumer gets from an Adviser does not produce inappropriate personal advantage to the Adviser.

   'Standard 2: [Relevant providers] Must neither advise, refer, nor act in any other manner, where inappropriate personal advantage is derived by the relevant provider.'

   We refer to the comments we have provided in the previous pages regarding issues relating to the wording used in the draft Code of Ethics.

   We do not think that the draft Code of Ethics in its current form addresses the consumer detriments that have arisen in the financial advice industry on the basis that it creates other issues for advisers and may result in an adviser breaching its legal obligations as a result of complying with the Code (for example, the requirement to obtain consent from a client to maintain records).

   In terms of specific consumer detriment we provide the following comments:

Conduct to address	Comments
Conflicts of Interest	We refer to our comments relating to Standard 2 and Standard 4.
Independence	We refer to our comments relating to Standard 2, 3 and 10
Client care	We refer to our comments relating to Standard 3 and 5(c)
Quality pf process	We refer to our comments relating to Standard 10
Quality of documentation	We have no comment
Statements of Advice	We refer to our comments relating to Standard 2, 4 and 5(c)
Quality of education and competence	We refer to our comments relating to Standard 10
Quality of output	We have no comment
Illegality	We are concerned as discussed in the points in the previous pages that some of the codes create a conflict with an adviser's legal obligations
A generalised lack of consumer trust	We have no comment

1(a) What types of personal advantage are appropriate vs inappropriate?

Assuming that FASEA retains Standard 2 in its current form then appropriate would be deemed any personal advantage that is authorised by the client provided it is not against the law.

1(b) What might be the unintended consequences of the current draft?

Assuming that FASEA retains Standard 2 in its current form then an unintended consequent could be that:

- It prevents an adviser from carrying on a business as it limits/ prevents them from generating an income.
- Usually an adviser does not provide dealing services so in order for a client to act on the advice provided the client needs to engage with a third party service provider or a product issuer. In these circumstances the adviser is acting as a referral agent to the third party service provider or product issuer and technically is not providing any advice regarding the act of referring the client to third party service provider or a product issuer. As part of the provision of advice an adviser must compare products available, it is impossible for an adviser to compare all service providers that provide dealing services and determine which one is the best one for the client, it makes no business sense and provides no additional benefit to the client because by the time such comparison is conducted the client is gone, the market has moved and the client's circumstances have changed.

1(c) How might the Standard be expressed to avoid unintended consequences?

We recommend that Standard 2 is changed to the following 'Must neither advise, refer, nor act in any other manner, where a conflict of interest is derived by the relevant provider'

However, assuming that FASEA retains Standard 2 in principle then we recommend that its current form be amended to delete the word 'refer' so it would read as follows:

'Must neither advise nor act in any other manner, where inappropriate personal advantage is derived by the relevant provider

2. How do the other Standards respond to this type of consideration?

We refer you to our comments in the earlier pages of this letter in this regard.

3. The practical application of the proposed Code in terms of

Adviser practice	Assuming no changes are made to the Code then for some advisers there could be serious ramifications as they will be required to drastically change their business model to comply with the Code whilst remaining compliant with the Law.
Licensee practice	Assuming no changes are made to the Code then many licensees may elect to amend its business model to a general advice only model thus removing he requirement to comply with the Code.
Education and support	The Code makes no direct reference to the Educational and Training standard however refers to relevant knowledge and skills which is ambiguous and potentially confusing.
Compliance requirements	Assuming no changes are made to the Code it could present a compliance nightmare as there is so much inconsistency between the Code and the Law.
Consumer experience	If a lot adviser leave the industry as a result of the proposed Educational and Training Standards and along with the draft Code then this will be to the detriment of the consumer as it will be limiting their choice, inadvertently removing experienced and qualified advisers from the industry.

ASDAA appreciates the opportunity to provide this Submission to ASIC on these significant proposals. We would be happy to discuss any issues arising from our submissions on this issue, or to provide any further material that may assist. Should you require any further information, please contact Brad Smoling, Director of Communications, on (07) 5532 3930 or email brad@asdaa.com.au.

Yours Sincerely

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