FINANCIAL PLANNING
ASSOCIATION *of* AUSTRALIA

FASEA CODE OF ETHICS GUIDANCE

Comments on consultation draft
2 November 2020

Introduction

The FPA has been calling on FASEA to provide appropriate guidance on its Code of Ethics since it was created in February 2019 and welcomes the release of this latest draft document. It is disappointing that it has taken so long for FASEA to provide this draft document, particularly given the Code of Ethics has been in force for 10 months already and financial planners are expected to comply with it.

The FPA has long supported the introduction of a mandatory, principles-based code for the financial planning profession. The FPA's own Code of Professional Conduct has been in place since the FPA's inception in 1992 and has been effective at setting behavioural standards for FPA members.

The challenge for FASEA in establishing a new professional code is building a strong and consistent understanding of the practical application of the code's principles in the broader profession to ensure that it is effective at setting standards and driving behavioural change. Confusion and inconsistent application of the principles will undermine confidence in the Code of Ethics and hamper its effectiveness as a reform.

FPA members have decades of experience in applying the FPA Code of Professional Conduct, backed by support from the FPA and the record of decisions on complaints from the FPA's Conduct Review Commission. Other professions have codes of conduct based on similar ethical principles to those contained in FASEA's Code of Ethics. However, they also have decades or even centuries of practical experience in applying them to their professional work, building a clear, common understanding within their profession.

Financial planners do not have such a shared experience and there can be differences in interpretation that are the result of legitimate and good faith application of the principles in the Code of Ethics. A shared experience will develop over time, although it has been delayed by the lack of a disciplinary body to apply the Code of Ethics.

It is in this context that guidance for the Code of Ethics is vital to quickly address potential areas of divergence in how it is applied by the profession. Guidance does not need to detract from the principled approach taken in setting the Code of Ethics. Nor does guidance need to provide a checklist for financial planners to substitute for using their own judgement.

Good guidance should effectively illustrate the principled reasoning that FASEA expects in relation to the Code of Ethics and ensure that there is a consistent application of those principles by financial planners in the most common scenarios.

This draft guidance is a positive step in managing the introduction of the Code of Ethics, although there is more work to be done. The FPA will continue to engage constructively with FASEA to smooth the introduction of the Code of Ethics and make suggestions for further guidance.

General comments

Consolidation of guidance

When finalised, this document will be the second piece of guidance issued by FASEA for the Code of Ethics. It is important that new guidance is consolidated into a single document to ensure that financial planners have a single source that covers all official guidance issued by FASEA. The FPA recommends that FASEA incorporates any new guidance into a single document, with clear version control for ease of reference.

More appropriate case studies

The case studies contained in this document that show the application of the Code of Ethics to practical situations are extremely valuable. However, the construction of those case studies and the answers to them could be better crafted. For example, case studies are most useful when they illustrate a difficult situation in which the application of a principle is nuanced and complex. Simple situations where the application of a principle is clear and obvious are rarely as helpful. Similarly, the final answer to a case study is often far less important than demonstrating the principled reasoning that leads to it.

Some of the case studies in this document have been well crafted and are useful additions to a common understanding of the Code of Ethics. In other cases, better examples could be used and the FPA has highlighted these throughout our feedback on the document.

Comments on specific standards

Standard 1

Financial literacy and the sophisticated investor threshold

The FPA does not consider that it is good regulatory practice for a piece of subordinate legislation, such as the FASEA Code of Ethics, to seek to change a test or threshold contained in primary legislation, such as the sophisticated investor provision in the Corporations Act 2001. This is not simply a case of extending an obligation but seeking to change a clear and well-established test that has been relied on to ensure compliance with the law.

Having said that, the FPA supports changing the sophisticated investor threshold by raising the prescribed level of income and assets and by including a financial literacy component.

Given the importance of the sophisticated investor test, the FPA recommends much clearer guidance on how a financial planner should determine whether a client has sufficient expertise to be considered a wholesale client. Ultimately, this guidance should be provided as part of an update to the provisions of the Corporations Act 2001 and the FPA has called on the Government to make this change.

Grandfathered commissions

Case study three refers to grandfathered commissions being payable on an investment product. Given the majority of grandfathered commissions have already been switched off and any remaining will cease by 1 January 2021, it would be helpful to include a more relevant situation in this case study. This case study also appears to be directed to the application of the best interest duty rather than understanding and abiding by the intent of the law. It would be worth including a clear statement that an incentive available to the financial planner in relation to a product is not a relevant consideration in whether that product is best suited for their client and should be recommended.

Standard 2

Best interests duty

As with standard one, the FPA is concerned about multiple standards in different parts of the regulatory framework that complicate compliance for financial planners. In the case of the best interest duty, the duty in standard two is one of three best interest duties that most financial planners must comply with - the others residing in the Corporations Act 2001 and the Tax Practitioners Board Code of Professional Conduct. While similar, each of these best interest duties is phrased slightly differently and the duty in the *Corporations Act 2001* includes a safe-harbour provision that is not present in the other two. The FPA has recommended to the Government that it consolidates the standards for financial planners to remove this sort of duplication as a potential source of confusion.

Rather than restate elements of the safe-harbour provision from the *Corporations Act 2001*, the FPA recommends this guidance focus solely on the application of the best interest duty contained in standard two of the FASEA Code of Ethics.

Client decisions on advice
The FPA recognises that clients who disagree with part or all of their financial advice present a challenge for financial planners. Financial planners should always consider the best interests of their client, including potentially refusing to facilitate an investment that is detrimental to their client's interests. However, this must be balanced against the rights of the client to accept or reject the financial advice they have received and to make their own decisions about their financial affairs.

Case study one could include a much better discussion on the factors that are at play when a client elects not to follow a financial planner's recommendation. In particular, it would be useful for the case study to better illustrate when FASEA believes a financial planner can continue to act for their client and when it would be more appropriate to terminate the client relationship.

This discussion should reflect the reality that this issue is likely to manifest after a financial planner has invested a significant amount of time into preparing the client's advice and should be remunerated for that effort.

Standard 3
Reasonable person test
Standard three has attracted some of the most significant criticism since the release of the Code of Ethics. The problem, as the FPA sees it, is that standard three is crafted as an absolute prohibition to act if there is a conflict of interest. As has been repeatedly pointed out, conflicts are common in all professions and it is similarly common for other professions to evaluate the materiality of a conflict and manage it appropriately.

FASEA has included a new test for standard three in this guidance document, which is essentially a "reasonable person" test of the sort found in other areas of law. The FPA supports the inclusion of this test as it will provide financial planners with enough flexibility to manage immaterial conflicts of interest without having to terminate a client relationship. This is a common-sense approach and should resolve many of the issues that were raised with standard three when it was first set.

However, the FPA remains concerned that the wording of standard three remains unchanged and that this guidance may or may not be considered or followed in decisions by a disciplinary body or an EDR scheme. The FPA strongly recommends that the text of standard three be amended to reflect the reasonable person test and the flexibility that it allows in looking at the materiality of a conflict of interest.

Remuneration
The effect of standard three on certain forms of remuneration has been highly debated and is a significant challenge for the financial planning profession. FASEA has stated that it does not prohibit any specific form of remuneration. Yet the new guidance document also states, "certain forms of remuneration will always fail to meet the requirements of the Code of Ethics".

The FPA strong view is that FASEA should not play semantic games with this topic and should be clear on what it considers the effect of standard three is on common forms of remuneration. By failing to address this issue properly, FASEA is encouraging confusion and inconsistent application of the Code of Ethics, which is not in the interests of the profession or Australian consumers.

FASEA does not need to be definitive in considering forms of remuneration, nor does it remove the onus from financial planners to apply the principles of standard three to their remuneration. However, some clear guidance on common forms of remuneration would promote a consistent understanding throughout the profession.

Separating clients
Case study number 2 is a welcome addition to the FASEA guidance as it deals with a common scenario in which a financial planner is acting for a couple who are going through a separation or divorce. The description of how the Code of Ethics could be applied to this situation is good, however it could be improved with some commentary on the possible actions available to a financial planner in this situation and how each option could be evaluated with respect to the Code of Ethics. For example, should a financial planner decline to act for either member of the couple, continue to act for one but not both, or are either of these viable options? What are the key ethical considerations that would affect such a decision?

Standard 4
Format of client consent
The FPA supports providing flexibility for financial planners in the manner in which they secure their client's consent to act. In case study seven, FASEA notes that this could be through existing forms of interaction with clients including engagement letters, Ongoing Service Agreements and the like. However, FASEA goes on to suggest that if one of these forms is not used, financial planners could use a record of conversation signed by the client. The FPA does not support requiring wet signatures for this purpose.

Financial planners have increasingly embraced electronic communication to ensure they are able to continue serving their clients under social distancing requirements and this trend is likely to continue as more clients become comfortable engaging in this manner.

The FPA strongly recommends that FASEA's guidance provides flexibility in the manner of receiving client consent, including through electronic communications. FASEA may wish to look at ASIC's recent guidance[1] on this issue.

[1] https://asic.gov.au/about-asic/news-centre/articles/covid-19-information-for-financial-advisers-and-advice-licensees/#can

Standard 5

Role of APLs in making product recommendations

Case study one and the case studies included under standard nine all relate to the use of Approved Product Lists (APLs) by financial planners. Each of these case studies imply that an APL may be a useful tool for financial planners in discharging their obligations but does not relieve the financial planner of applying their own judgement to available financial products and their suitability for their client. It may be useful to make this point more explicit in the answer to case study one.

Client understanding

A consistent theme in the feedback from financial planners on the Code of Ethics has related to ensuring that clients understand the advice that has been given to them. In particular, there is some concern about clients who may have difficulty in understanding their financial advice, but who wish to continue with their financial planner and for whom ending an advice relationship may not be in their best interests.

Case study number two does not assist in illustrating this difficult issue - it is clear that a client has not demonstrated their understanding of financial advice simply by signing an authority to proceed. A better case study on this issue would highlight some possible factors that a financial planner might consider in determining whether a client has understood their advice and, in the event that they have not understood, what options might be open to the financial planner to resolve the issue that do not disadvantage the client by terminating their advice relationship.

This can be a particularly important matter for financial planners advising older Australians who may have started to show signs of reduced capacity to manage their own affairs. While this issue may extend beyond the scope of the Code of Ethics, clear guidance on how the Code of Ethics should be applied in these circumstances would be useful and could then be supplemented by best practice guidance within the profession.

Standard 6

Application to scaled advice

Another area of significant concern for the Code of Ethics is the application of standard six to the provision of scaled advice. It should be noted that there is broad reluctance from many AFS licensees to provide scaled advice due to the uncertainty over what is required by regulation when providing it and that this concern extends well beyond the Code of Ethics. In an environment focused on compliance and close scrutiny of the services provided to clients, it is understandable that many licensees have reacted to this regulatory uncertainty with an abundance of caution by ceasing to provide scaled advice entirely.

While the FPA understands FASEA’s goal in taking a principled approach in setting the Code of Ethics and not prescribing specific compliance steps, the uncertainty over the application of standard six is contributing to the reluctance of licensees to offer scaled advice.

The Australian Securities and Investments Commission (ASIC) has commenced a project to identify the barriers for licensees in providing scaled advice and making recommendations to address them. As part of the regulatory landscape for financial advice, FASEA and the operation of the Code of Ethics must be included in these considerations. The FPA recommends that FASEA engages with ASIC on this project as a matter of priority.

While this work is underway, the FPA also recommends that FASEA provides a case study that explores the type of considerations that a financial planner might make in determining whether scaled advice is appropriate for their client. This type of example would not detract from FASEA's principled approach and would provide some reassurance to licensees that scaled advice is a viable option that can be delivered without undue compliance risk.

Standard 7

Wet signatures

Case study three suggests that a client must provide a wet signature on a physical document to demonstrate they have consented to benefits a financial planner receives in relation to their services. This is an unnecessary and out-dated method of getting and recording agreement from a client. As discussed under standard four above, financial planners have increasingly embraced electronic communication to ensure they are able to continue serving their clients under social distancing requirements and this trend is likely to continue as more clients become comfortable engaging in this manner.

The FPA strongly recommends that FASEA's guidance provides flexibility in the manner of receiving client consent, including through electronic communications. FASEA may wish to look at ASIC's recent guidance on this issue.

Standard 8

Maintaining client confidentiality

Case study one looks at a financial planner's transition to a cloud-based filing system. Case study two considers the treatment of client files when a financial planner moves practices. Both scenarios should trigger a consideration of maintaining privacy and client confidentiality.

FASEA may wish to review the guidance provided by the Tax Practitioners Board (TPB), which applies to tax (financial) advisers, in relation to this issue. The TPB's guidance[2] is thorough and considers the issue of disclosure to third parties, such as cloud computing providers, offshore support services and licensees in some detail.

Standard 9

Role of APLs in making product recommendations

As discussed under standard five, it may be useful to clarify how a financial planner can use an APL to assist them in discharging their ethical obligations to their client.

Case study one should state more clearly that the presence of a product on an APL does not relieve a financial planner of their duty to understand the product and ensure it is appropriate for their client before recommending it. Case study two makes the obvious point that the

[2] https://www.tpb.gov.au/tpbi-322017-code-professional-conduct-confidentiality-client-information-tax-financial-advisers

presence of a product on an APL does not constitute evidence that it is appropriate for the client and a financial planner should properly record the reasoning behind any recommendation of that product.

Another point that may be useful to explore through a further case study is the extent to which a financial planner can rely on an APL and the research undertaken by their licensee to be satisfied that they understand the broad options for financial products that are available to recommend. For example, it could be assumed that an APL and associated product research will be of great assistance to a financial planner, but does relieve the financial planner of an overarching obligation to consider relevant financial products which are not on the APL.