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ASIC Enforcement Review
Financial System Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: ASICenforcementreview@treasury.gov.au

Dear Taskforce Members

AFA Submission – Consultation: Industry Codes in The Financial Sector

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for 70 years. Our objective is to achieve *Great Advice for More Australians* and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

The Board of the AFA is elected by the Membership and all Directors are required to be practicing financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting wealth.

Introduction

The AFA supports measures to increase the standards that apply in the financial services industry, provided that they will deliver material benefits in a cost effective manner. We note that this consultation paper is strongly based upon ASIC approved codes. It needs to be noted that despite the ASIC approval mechanism existing for many years, there is only one ASIC approved code in existence, which came into force on 1 July 2017 and only applies to a small number of participants. This particular code took a number of years to be approved and provides a mechanism for financial adviser to avoid compliance with the Opt-In law (Corporations Act Section 962K) by agreeing to comply with alternative obligations under a code of conduct. In our view this does not present a benchmark for the benefits of an ASIC approved code.

It is our view that the consultation paper does not adequately articulate a case for why the current approach with industry codes is not effective. The point is made that some of the codes do not cover 100% of the market place. Action could be taken to address this. In paragraph 17, the consultation paper refers to "key subsectors where gaps in coverage and or problems or ambiguities around enforcement of codes have been identified", yet the paper fails to set out any details on what these problems are.

On this basis, we do not believe that we have enough evidence that ASIC approved codes would deliver a better outcome than industry led and managed codes of conduct. A fundamental change to a range of existing codes will have a substantial effect on the financial services industry which might deliver no net benefit to consumers. It should be noted that the consultation paper clearly states that codes should be set at a base level, rather than best practice, which is likely to have the effect of lowering standards in a number of areas.

Codes of conduct can apply to both entities operating in an industry and individuals in the form of professionals. There is a fundamental difference. The consultation paper asserts that internal and external dispute resolution schemes should apply across all codes. It should be noted that in some situations, the legal liability to the consumer to address unsatisfactory performance may rest with the entity and not the professional. Asserting an external dispute resolution mechanism across both the entity and the professional may generate a lack of clarity as to who needs to do what.

We note the stated preference that a single approved code should cover a sector. This might not be possible, particularly in the case of professionals where there are multiple professional associations or also with some industries where there is more than one industry group. It is also noted that such an approach may result in one entity being bound by multiple codes. This could potentially cause complications as consumers may be unclear on who to complain to and there may be confusion between code monitoring bodies as to who would be required to investigate a particular breach or complaint.

We also envisage a potential issue where an existing code might continue to apply for some existing consumers, potentially where it has been written into their contracts, and yet the new ASIC approved code might apply for newer customers, creating further confusion.

Applying a "one-size-fits-all" approach to the management of codes of conduct across the entire financial services industry will have a range of potentially negative consequences. It is our view that the requirement for an ASIC approved code should only be enforced on a sector by sector basis and only when fundamental gaps or deficiencies are identified and the industry participants have failed to address these issues within a reasonable timeframe.

Response to Questions Raised in the Consultation Paper

1. Would a requirement to subscribe to an ASIC approved industry code result in improved outcomes for consumers?

This question can only be answered on a case by case basis. It should also be viewed differently on the basis of whether it was the case of a new code or involved the replacement of an existing industry code. It would seem to make better sense to take the ASIC approved path where a new code is being built from scratch and there is no existing code. This would ensure that all participants were included and adequate enforcement mechanisms existed.

In the case of an existing code where the standard was potentially being lowered from best practice to a base level (Consultation Paper - paragraph 19), then it would appear likely that no benefits would be generated and significant costs would be incurred. It also needs to be appreciated that the whole process of establishing an ASIC approved code can be lengthy and that industry stakeholders

would be distracted during this period from their primary focus on delivering value to their clients. Where an existing scheme already exists and where other means are available to fix any gaps then it is most likely a better option to pursue industry led improvements to the existing code of conduct arrangements, before considering the path of an ASIC approved code.

2. In respect of which financial sector activities should the requirement apply?

As stated above, we do not believe that the consultation paper clearly sets out which sectors have fundamental gaps and deficiencies in their codes of conduct and for this reason, we are not in a position to express a view on which sectors this should apply to.

3. Should these requirements apply to providers of services covered by the ePayments Code or should the code be mandated by other means? If so by what means?

The ePayments code is an existing code that is already administered by ASIC. It would appear that this code is already working effectively, although it may not cover all relevant participants. If the core issue is the fact that it doesn't cover all participants, then a range of measures should be considered to ensure that all market participants are covered. This might be through a combination of "carrot" and "stick" measures. One market based option would be for membership of the code to be used as a marketing point for consumers so that customers will choose a provider based upon whether they are covered by the code or not. In our view, it would be better to see how the existing code can be made to work better, before consideration was given to re-establish the ePayment code as an ASIC approved mandatory code.

4. What costs or other regulatory burden would the requirement imply for industry?

There would be significant costs involved in the implementation of this proposal. Some of these costs would include the following:

- Each code would need to be reviewed and assessed for necessary changes. This is likely to involve extensive legal work.
- New enforcement procedures would need to be developed.
- A new code monitoring body would need to be established.
- The new code would need to be subject to community consultation (as required under Regulatory Guide 183).
- Additional resources would need to be recruited to manage the requirements of the new code.
- Any existing documents relating to the code would need to be disposed of and new documentation would need to be developed and issued. This could impact a large number of documents including things like contracts.
- AFS licences would need to be updated to insert provisions that enable the means by which compliance could become mandatory.
- Business processes and IT systems might need to be modified to reflect any changes to the code.
- Staff would need to be retrained on the new code.
- Changes to the code of conduct may also impact upon professional indemnity insurance.

This is a high level list of some of the areas that would be impacted. It is important to note that many of the above considerations would apply to every entity in the sector. Significant work and cost would be incurred by any industry and/or professional association that was involved.

5. Should conduct associated with subscription to approved codes be deemed to be authorised under section 51 of the Competition and Consumer Act?

It is our view that should a code become subject to ASIC approval and a co-regulatory model then it would be preferable that only one regulatory body was involved. It would not make sense to have both ASIC and the ACCC operating as direct regulators.

6. Will ensuring enforceability provisions of codes meet a minimum standard improve consumer outcomes?

Once again this will vary from sector to sector and case to case. Where the vast majority of participants already operate at the required level then enforceability provisions are unlikely to have much impact. In addition, enforceability provisions may have no impact if the particular entity is insolvent and incapable of addressing the matter.

7. Do any problems arise with imposing these requirements in relation to particular financial sector activities?

We have not assessed every potential sector in detail, however we point out that issues may arise in the following circumstances:

- Members of professional associations, where the liability for any inappropriate conduct rests with the entity that they are employed by or authorised by and therefore duplicate dispute resolution arrangements might apply.
- Situations may exist where a remedy may be available under both the legislation and the code of conduct, with different schemes available. This would be confusing for clients who might not know which one to pursue.
- In the example of financial advisers, it is important to appreciate that there is a third party, being the Australian Financial Services Licensee, who are responsible for complaints under the Corporations Act, both via internal and external schemes. It is only the licensee that can deal with compensation of clients. A financial adviser might also be bound by a code of conduct as a member of a professional association, however professional associations are not able to determine awards in the favour of the client. The same issue is likely to apply in other industry context.
- Multiple codes and code monitoring arrangements apply to the one firm, resulting in either confusion or duplication of activity.
- It is also important to ensure that any element of a code of conduct does not result in anti-competitive behaviour.

8. Are contractual arrangements with code monitoring bodies the most effective enforcement mechanism?

In our experience, through the operation of the External Dispute Resolution schemes under the Australian Financial Services regime, contractual arrangements are an effective way of holding participants accountable. This is in most cases effective, unless the business becomes insolvent and they no longer have the capacity to address the issue/complaint.

9. Is it appropriate that, where feasible, code content be incorporated into contracts with customers?

Once again, the answer to this question will vary on a case by case basis. It would seem appropriate where a formal contract exists and the code of conduct reflects part of the contractual terms for the customer, that it be incorporated. This might simply be by reference to the code rather than by repeating the entirety of the code in the contract. Incorporation of the code into the contract could apply whether the code is ASIC approved or not.

10. Should the composition of individual code monitoring bodies and arrangements for enforcement be subject to ASIC approval?

ASIC Regulatory Guide 183 on the approval of codes of conduct defines very clear requirements for code administrators who are required to monitor the code and also the enforceability of codes. Therefore, if a code is to be ASIC approved then it will need to comply with the RG 183 requirements with respect to code monitoring bodies and enforcement. It is our view that if a code is to be ASIC approved then all elements will need to comply with RG 183. If a code is not going to be ASIC approved then it is unlikely that ASIC will look at any elements of the code.

11. What characteristic should code-monitoring bodies have (for example, what level of independence should they have?)?

The AFA believes that the requirements of ASIC in RG 183 with respect to code monitoring reflects best practice. This includes the independence of the code monitoring body, the adequacy of resources and the description of the role of the code administrator or code monitoring body. It is our view that the code monitoring body needs to have an independent chair and a balance of consumer and industry representatives.

The AFA's Suggestions on the Operation of ASIC Approved Codes

Under the Corporations Amendment (Professional Standards of Financial Advisers) Bill 2016 (the "Professional Standards Legislation"), ASIC will approve code monitoring schemes for financial advisers and all financial advisers will need to belong to a scheme by 1 January 2020. The AFA is supportive of this measure and is keen to ensure that this new regime delivers on the objective of raising the level of professionalism in the financial advice sector. We would like to ensure that the introduction of these new requirements is discharged fairly, effectively and efficiently as between all applicants.

The AFA intends to be a code monitoring body of a compliance scheme, under the Professional Standards Legislation. In our view, it is important that the criteria ASIC applies in approving compliance schemes are tailored to reflect the size and resources of all applicants, so that smaller organisations are not competitively disadvantaged in having a compliance scheme approved. In addition, the approval process and timing of approval should be fair so that organisations are not disadvantaged competitively vis a vis another organisation, for example, by the fact that one organisation might be approved prior to others. It is appropriate that the approach is designed to address this issue.

The AFA considers that ASIC should not adopt a "one size fits all" approach when assessing the merits of an organisation's application to become a code monitoring body under the Professional Standards Legislation. We believe that fairness should be accorded to each applicant so that competitive neutrality is preserved. We note that the cost to larger organisations of running a compliance scheme can be allocated across a larger member pool compared to that of smaller organisations.

The timing of approval of code monitoring schemes should be fairly treated between applicants so that no organisation is unfairly disadvantaged. It would be unfair for the first organisation to have its scheme approved by ASIC to obtain a competitive advantage in attracting members away from other organisations (who are still awaiting approval from ASIC).

Other Issues

We are conscious that the proposal in this consultation paper involves ASIC approval of codes of conduct for sectors of the financial services industry where ASIC considers a code is required. This places a lot of power with ASIC, in that they can determine what sectors need an ASIC approved code and they can then influence what will be in the code and then they need to approve the code. It is our view that, should the Government choose to proceed with this proposal, that there would need to be some separation of power and that it does not make sense for ASIC to make the final determination with respect to which sectors require an ASIC approved code of conduct.

Concluding remarks

The AFA welcomes further consultation with the Taskforce should it require clarification of anything in this submission. If required, please contact us on 02 9267 4003.

Yours faithfully

Philip Kewin
Chief Executive Officer
Association of Financial Advisers Ltd