

financial services newsletter

Regulation and Compliance

Information contained in this newsletter is current as at July 2005

Proposed new professional standards on managing conflict of interest for financial planners

June Smith ARGYLE LAWYERS

The Financial Planning Association of Australia (FPA) has released draft principles¹ designed to assist financial planners in managing potential or perceived conflicts of interest that might arise when providing financial product advice under the *Corporations Act 2001* (Cth).

The draft principles are subject to a six month consultation period which expires on 28 October 2005. They are the third stage in a three part project. The first part comprised the Investment Financial Services Association (IFSA) and the FPA Code of Practice on Alternative Remuneration² which became operational on 1 August 2004. The second part was the Industry Guide on Rebates and Related Products which was adopted on 1 January 2005.³

Main legal obligations.

Section 912A(1)(aa) of the *Corporations Act* states that Australian financial services (AFS) licensees must:

Have in place adequate arrangements for the management of conflicts of interest that may arise wholly or partially in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services as part of the financial services business of the licensee or the representative.

The Australian Securities and Investments Commission (ASIC) Policy Statement (PS) 181,⁴ which became operational on 1 January 2005, outlines how ASIC will generally interpret this

statutory obligation.

PS 181.15 defines a conflict of interest as:

Circumstances where some or all of the interests of people (clients) to whom a licensee (or its representatives) provides financial services are inconsistent with, or diverge from, some or all of the interests of the licensee or its representatives. This includes actual, potential and apparent conflicts of interest.

The licensee's obligation to comply with the primary matters raised in PS 181 is linked to the professional obligations of their advisers.

PS 181 does not prohibit all conflict of interest or prohibit the licensee from providing financial services if a conflict of interest exists, but there is an expectation that all conflicts of interest will be adequately managed.

Without adequate conflict of interest management procedures in place, it is unlikely that a licensee will be acting 'efficiently, honestly and fairly' as required under s 912A(1)(a) of the *Corporations Act*, the main aim of which is to ensure that the quality of the financial services offered by the licensee is the same, irrespective of whether or not a conflict of interest has arisen.

Professional obligations

Most professional associations have ethical rules for members on objectivity and conflict of interest.

The Code of Ethics and Rules of Professional Conduct of the FPA,⁵ for

Table 1: Changes in practice — key elements

No	Principal	Proposed application	Some desired outcomes for consumers and expected changes in practice
Key	FPA members have primary obligation to provide advice which is in the interests of and to the benefit of, the client.		<ul style="list-style-type: none"> • A perceptible shift in savings adequacy and financial protection coverage attributable to advice. • Enhanced client understanding of member advice and information on fees.
1	A financial planner will provide a client with clear, concise and comprehensive information so that the client will understand the advice and service being offered and its cost.	Builds upon the disclosure provisions of the <i>Corporations Act</i> and other professional requirements.	<ul style="list-style-type: none"> • A one page fee template. • Creation of standard industry terms and disclosure format. • Consumer information articulated in plain English.
2	Financial planning advice should be independent from, and not tied to, product recommendations.	Unbundle fees so as to identify and separate those relating to advice and product manufacture.	<ul style="list-style-type: none"> • Advice unbundled from manufacturing. • The advice fee is still able to be collected via the product or platform. • Customer agrees to pay an appropriate fee for the advice provided. • Trailing commissions would be known, identified and recognised as service remuneration for ongoing advice.
3	Where it is appropriate to recommend a product to a client, all FPA members should only offer products which suit the needs of the client and will not bring the industry into disrepute.	Focuses attention on the long term interests of the client and the financial planning sector.	<ul style="list-style-type: none"> • Collective action across financial planners not to recommend a particular product or class of products.
4	No FPA member shall receive any remuneration or benefits which are biased against or may not be in the best interests of the client.	Recognises the AFS licensee as the 'gatekeeper' for industry remuneration structures.	<ul style="list-style-type: none"> • An AFS licensee would not reward its financial planners in any way that could (or could be perceived to) bias advice to one product manufacturer over another, including dealer splits, BOLR (buyer of last resort) and equity schemes where preference is given to internal product. • All volume related soft dollars to be eliminated in line with recent codes. • Consumers receive product recommendations appropriate to their circumstances.
5	A financial planner must disclose to a client any existing or potential financial interest (such as shareholdings or equity entitlements) they, or an entity in which they have an interest, have in the products or platforms they use and/or in their AFS licensee or related entity.	Requires disclosure if a financial planner has dealt in an equity in which they had either a direct or indirect interest.	<ul style="list-style-type: none"> • Full disclosure in financial services guide/statement of advice of any interests that an adviser has in the products or services they use.
6	There should be separate corporate governance in place between an AFS licensee and related fund managers and product/platform manufacturers within the same group.	To protect the client's interests from possible conflicts with those of the AFS licensee's shareholders.	<ul style="list-style-type: none"> • One objective of the corporate governance structure for AFS licensees should be that its financial planners have a primary obligation to provide advice which is in the client's interests.
7	FPA Members have a responsibility to abide by the FPA Principles to address any real or potential conflicts of interest.		<ul style="list-style-type: none"> • Members agree to adopt a principle based approach to conflict of interest.

example, states that members shall disclose to the client any limitation on their ability to provide objective services. Further, r 103(e) imposes an obligation on principal members to ensure that prospective clients are clearly informed in writing about the nature and extent of any significant financial relationship or connection with a product provider and any other material conflict of interest. Rule 117 articulates the same rule for conflicts that arise following the commencement of the client relationship. The onus is on the member to demonstrate that the client was made aware of any actual or potential conflict of interest.

CPA Australia and the Institute of Chartered Accountants⁶ also require that in the provision of financial advice:

[M]embers must act fairly and must not allow prejudice, conflict of interest or bias to override their objectivity. When providing financial advice, they must maintain an impartial attitude and recommend solutions that meet the client's situation.

There is a corresponding duty to act with professional independence and in

the best interests of the client.

New principles for managing conflicts of interest

The FPA's draft principles⁷ include one key and seven subsidiary principles. In its consultation draft, the FPA has highlighted some examples of changes to the practice of financial planners that it expects from the implementation of the principles, together with expected outcomes for consumers. Table 1 on p 39 summarises the key elements:

The FPA has announced that it will hold discussions with IFSA in relation to a co-operative approach with fund managers, given that some of the matters dealt with in the draft principles are beyond the sole responsibility of financial planners.

The draft principles are open for consultation until 28 October 2005. ●



June Smith,
Financial Services Industry
Consultant and Partner,
Argyle Lawyers,
<jsmith@argylelawyers.
com.au>.

Endnotes

1. FPA 'FPA proposes Principles to Manage Conflicts of Interest' media release 28 April 2005.
2. IFSA/FPA 2004 *Industry Code of Practice on Alternative Forms of Remuneration in the Wealth Management Industry*.
3. IFSA/FPA 2005 *Industry Guide on Rebates and Related Products*.
4. ASIC Policy Statement 181 — 'Licensing: Managing conflicts of interest'.
5. FPA *Code of Ethics and Rules of Professional Conduct*, reg 1/97.
6. CPA Australia and Institute of Chartered Accountants, APS 12 — Statement of Financial Advisory Services Standards (exposure draft), March 2004.
7. FPA, Draft Principles to Manage Conflicts of Interest, 28 April 2005.