



ASIC

Australian Securities & Investments Commission

REPORT 329

Response to submissions on CP 191 FOFA: Approval of codes of conduct for exemption from opt-in requirement

March 2013

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 191 *Future of Financial Advice: Approval of codes of conduct for exemption from opt-in requirement* (CP 191) and details our responses to those issues.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

This report does not contain ASIC policy. Please see our updated guidance in Regulatory Guide 183 *Approval of financial services sector codes of conduct* (RG 183).

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A Overview/Consultation process

- 1 In Consultation Paper 191 *Future of Financial Advice: Approval of codes of conduct for exemption from opt-in requirement*, we consulted on proposals to update our guidance in Regulatory Guide 183 *Approval of financial services sector codes of conduct* (RG 183) to administer our power to approve codes under s962CA of the *Corporations Act 2001* (Corporations Act).
- 2 We consulted on a number of proposals to amend our existing guidance to cater for codes approved under s962CA.
- 3 This report highlights the key issues that arose out of the submissions received on CP 191 and our responses to those issues.
- 4 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 191. We have limited this report to the key issues.
- 5 For a list of the non-confidential respondents to CP 191, see the appendix. Copies of the submissions are on the ASIC website at www.asic.gov.au/cp under CP 191.

Responses to consultation

- 6 We received 12 responses to CP 191 from Australian financial services (AFS) licensees, industry associations, a law firm and a joint consumer submission. We are grateful to respondents for taking the time to send us their comments.
- 7 The main issues raised by respondents related to whether we should:
 - (a) amend RG 183 to provide for codes that are limited in scope to provisions that will, in combination, obviate the need to comply with the opt-in requirement in s962K;
 - (b) amend RG 183 to provide for codes with limited industry coverage;
 - (c) amend our existing requirements in RG 183 relating to code administration, monitoring, enforcement and review for codes approved under s962CA;
 - (d) adopt content requirements for codes approved under s962CA and decide what those content requirements should be; and
 - (e) require code applicants to maintain a register of code members.
- 8 Respondents were generally supportive of our proposals to amend our codes approval policy to provide flexibility in the type of codes approved under s962CA. Respondents appreciated the challenges in striking a balance between

the need to meet the statutory criteria in s1101A and our existing guidance, and meeting the specific objectives of a code approved under s962CA while delivering robust codes that stakeholders can have confidence in.

- 9 Respondents held divergent views about the scope of codes that should be approved under s962CA. Respondents were divided between those advocating broad-based, comprehensive codes that address a wider range of issues relating to the provision of financial advice beyond the opt-in requirement, and those advocating codes that are limited in both content and/or membership.
- 10 There were similarly divergent views among respondents about whether we should retain our existing guidance on administration and compliance arrangements for codes approved under s962CA. Most respondents supported the maintenance of our current guidance, noting that it is essential for stakeholder confidence that codes are, and are seen to be, robustly and effectively administered and complied with. Other respondents argued that administration arrangements should be tailored or relaxed according to the type of code under consideration.
- 11 We have taken this feedback into account in our final updated guidance: see Section E of the revised RG 183.

B Response to submissions on CP 191

Key points

This section outlines the key issues raised in the submissions on CP 191, and our responses to those issues. It covers:

- the scope of codes that we should approve under s962CA;
- code administration, monitoring and governance;
- content requirements for codes approved under s962CA;
- registers of code members and independent reviews; and
- codes and AFS licensee obligations.

Scope of codes we will consider for approval under s962CA

- 12 We consulted on two issues relating to the scope of codes that we should consider for approval under s962CA. We asked whether we should modify our existing guidance in RG 183 to:
- (a) consider codes that are limited in scope to the standards or requirements that we are satisfied will, in combination, obviate the need for complying with the opt-in requirement in s962K; and
 - (b) permit consideration of a code sponsored by a single AFS licensee or dealer group, or a small number of licensees or dealer groups.
- 13 The proposal to consider for approval under s962CA codes that are limited in scope (see paragraph 12(a)) received general or qualified support from a majority of respondents. These respondents acknowledged that the law did not preclude such codes from being approved by ASIC and that, given the specific focus of the opt-in requirement, it was appropriate for ASIC to consider such codes for approval under s962CA.
- 14 A minority of submissions opposed the proposal to consider for approval under s962CA of codes that are limited in content, arguing that only holistic, comprehensive or professional codes of conduct that governed the entirety of the adviser–client relationship would be sufficient to satisfy the statutory objective of s962CA. One submission argued that any limited codes approved by ASIC under s962CA should be subject to a number of additional conditions, including restrictions on marketing and nomenclature, and that these codes should extend to cover existing as well as new clients after 1 July 2013.
- 15 In consulting about whether we should modify our approach to code membership for codes approved under s962CA (see paragraph 12(b)), we

- noted that such a proposal would be a significant departure from our existing guidance. We expressed our serious reservations about whether such a code with limited industry coverage could ever be credibly and independently administered, or have the confidence of consumers and other stakeholders as an acceptable alternative to complying with the law.
- 16 Submissions that were supportive of this proposal argued that AFS licensees were best placed to manage the compliance of representatives, and that such codes could leverage licensees' existing internal compliance arrangements and would introduce a competitive driver among licensees for setting standards that exceed the law.
- 17 Other submissions noted the significant conflict of interest for an entity to have the benefit of an exemption from the law on the basis that it administers its own code of conduct, or gave qualified support to this proposal only if the code was subject to external, independent administration.
- 18 Submissions opposing codes with limited industry coverage argued that this proposal had the potential to generate a proliferation of codes of various scope and quality, which would undermine ASIC's ability to meet the statutory criteria in s1101A—that is, the desirability of codes of conduct being harmonised to the greatest extent possible.
- 19 Respondents also argued that the inherent conflict of interest could not be resolved and that such codes could not be effectively administered and enforced. Moreover, these submissions argued that it was essential for codes of conduct to have stakeholder confidence, that this could only be achieved if there was confidence that the code was robustly and effectively administered, and that the role of an AFS licensee was irreconcilable with the role and function of an administrator of a code.

ASIC's response

While the proposal to permit codes that are limited in scope is a departure from our existing guidance, the opt-in requirement is a provision designed to achieve a specific and limited objective (i.e. to ensure that disengaged retail clients do not pay ongoing advice fees and receive little or no service in return for those fees).

Our power to grant relief under s962CA permits consideration of codes that are limited in scope (or content) to provisions that will together obviate the need to comply with the opt-in requirement.

We have therefore amended RG 183 to provide for codes to be approved under s962CA that are limited in scope (or content). These are now defined in RG 183 as a 'limited code'.

Subscribing to a code approved by ASIC under s962CA, regardless of whether it is a code with limited content or a more comprehensive code, should be a signal to consumers that they can have confidence in both the subscriber and the code.

Our guidance therefore retains our existing standards for monitoring and enforcing compliance with a code, and we will not be relaxing these requirements for codes approved under s962CA, regardless of their scope: see paragraphs 20–22 and ASIC’s response.

In consulting about whether we should modify our approach to code membership for codes approved under s962CA, we expressly articulated our concerns with this approach as an alternative to compliance with the opt-in requirement.

In considering this issue, we took into account the submissions received and our statutory obligation to consider the ability of a code applicant to ensure that subscribers to the code would comply with the code and the desirability of codes to be harmonised to the greatest extent possible.

Approved codes of conduct are co-regulatory instruments that complement and expand on a code subscriber’s obligations under its AFS licence and the general law. Our threshold test for what we consider to be a code is that it is ‘a body of rules that sets enforceable standards across an industry (or part of an industry), and delivers measurable consumer benefits’: RG 183.19. This means that the commitments in a code are public, enforceable and transparent.

Our power to grant relief under s962CA from the opt-in requirement provides a person or class of persons an alternative to complying with the law. The consequence for a failure to comply with the opt-in requirement in s962K is that the fee arrangement terminates. If a fee arrangement terminates, the fee recipient must not continue to charge an ongoing fee: s962P. A civil penalty may apply to an adviser who charges ongoing fees after the fee arrangement has terminated.

Given the significant consequences that flow from a failure to comply with the opt-in requirement, or from continuing to charge a fee after the fee arrangement has terminated, we think that a code to which fee recipients subscribe as an alternative to complying with the law must be robust and at arm’s length from the commercial imperatives of a financial services business.

Respondents supporting codes operated by a single entity also argued that these codes should not be subject to the same level of public consultation nor independent administration.

On reviewing all the arguments, we do not consider that a code sponsored by a single AFS licensee or dealer group, or a small number of licensees or dealer groups, meets the threshold test of a code, as set out in RG 183, or satisfies the statutory requirements for harmonisation and compliance.

To avoid doubt, RG 183.95 expressly precludes such codes from consideration for approval under s962CA.

Code administration, monitoring and governance

- 20 In CP 191, we consulted about whether we should retain our current requirements for consultation, administration and enforcement of codes approved under s962CA.
- 21 Some respondents argued strongly in favour of retaining existing guidance about code administration, compliance monitoring and governance arrangements on the basis that code compliance and reporting must be carried out independently from industry subscribers and that this was essential to maintaining public confidence in a code that provides subscribers with an alternative to complying with the law.
- 22 Other respondents argued, albeit from different perspectives, that we should modify our requirements for code compliance and administration. Some respondents stated that the requirements should be amended for codes with limited subscribers to bring compliance ‘in-house’ to benefit from a licensee or dealer group’s existing compliance function, or that requirements should be scaled back for codes with limited content. Other respondents argued that it might be appropriate to relax our expectations for administration and compliance arrangements where professional industry bodies were responsible for the code.

ASIC’s response

RG 183 retains our existing high-level requirements for code administration, monitoring and enforcement. Our current guidance is principles based and, given that subscribers to a code approved under s962CA have the benefit of relief, we believe that robust compliance arrangements are essential to retaining public confidence that code subscribers comply with, and are seen to comply with, the code.

Our guidance does not preclude or undermine industry ownership of existing codes. It does, however, require these codes to establish and maintain transparent and independent administration arrangements for codes that wish to obtain and retain ASIC approval under s962CA. Robust and effective compliance and enforcement arrangements conducted at arm’s length from stakeholder interests are essential for codes that all stakeholders, including ASIC, can have confidence in.

Content requirements for codes approved under s962CA

- 23 In CP 191, we included a table setting out some examples of possible code content that ‘obviates the need’ for complying with the opt-in requirement. We asked for further practical examples of code content that would address the key policy issues of engagement, service delivery and value for money for clients paying ongoing fees for financial advice. We specifically asked for industry views about:

- the essential elements of a code that would obviate the need for complying with the opt-in requirement;
- services that warrant the payment of ongoing fees;
- services that are currently provided to clients in connection with ongoing fees;
- new or prospective models for service provision after 1 July 2013; and
- strategies for client engagement.

24 We also proposed that it is the responsibility of a code applicant to establish that its code contains provisions that obviate the need for complying with the opt-in requirement, taking into account the underlying policy intent of s962K.

25 Respondents generally supported the view that code applicants should identify the specific measures in their code that together satisfied the ‘obviates the need’ test. However, there were strong reservations expressed by a number of industry participants about the examples contained in CP 191.

26 Most submissions argued that the proposed guidance and examples were insufficient and that more detailed and appropriate guidance on code content that would satisfy the ‘obviates the need’ test was necessary. A number of respondents argued that the guidance was insufficiently detailed to enable them to decide whether to proceed with an application for code approval. Other respondents took the opposite view, maintaining that there was no code content that could provide a meaningful alternative to the opt-in requirement.

27 Despite the diversity of views, a number of respondents provided both principles-based and practical examples of the types of behaviour that would improve the quality and value of services clients receive for the ongoing fees they pay, and would support good client engagement and re-engagement strategies.

28 Several respondents supported the need for a code to require that clients actively renew an ongoing fee arrangement about every three years. One respondent argued that renewal should occur as regularly as every six months. Other respondents argued that a code approved under s962CA should not prescribe the renewal of ongoing fee arrangements because this resembled too closely the underlying opt-in requirement. Most respondents did not support any reference in RG 183 to a ban on asset-based fees as an example of code content.

ASIC's response

The advice process for new clients involves identifying a client's needs and objectives, negotiating the scope and cost of the advice services, implementing the advice, and delivering advisory services consistent with the agreement entered into with the client.

There was strong consensus that ASIC needed to give more detailed guidance about code content that 'obviates the need' for complying with the opt-in requirement, and that this was necessary to assist industry in deciding whether to develop or amend a code for approval under s962CA.

There was also some consensus, in the examples provided by respondents, on what is appropriate code content that meets the 'obviates the need' test.

In response, the updated RG 183 now includes an 'if not, why not' checklist (see the appendix) to guide code applicants on the code provisions that we consider will, in combination, meet the policy objectives of the opt-in requirement. A code that meets these objectives should include content that deals with:

- entering into an ongoing fee arrangement with a client;
- delivering services under the arrangement; and
- renewing the arrangement.

In giving our guidance in this format, we are not adopting a 'one-size-fits-all' approach. The checklist is instead designed to allow code applicants to focus on the practices that we consider meet the policy objective.

We accept, however, that code applicants may come up with different code content which still meets the underlying policy objectives. For this reason, we have structured the checklist so that a code applicant should either:

- state that the code includes the measures set out in the checklist; or
- if the code does not include the measures, explain why this is so and its alternative approach.

We consider this approach better meets the needs of prospective code applicants because it gives more detailed guidance, balanced with a degree of flexibility for applicants to innovate and include code content that more appropriately meets the needs of their membership and the ultimate beneficiaries of the code—the clients.

Registers of code members and independent reviews

29 In CP 191, we proposed that the administrator of a code approved under s962CA should maintain a public register of subscribing members who are exempt from the opt-in requirement. In many cases, the opt-in requirement will apply to individual advisers who would need to join an approved code in their own right if they elected to subscribe to a code as an alternative to complying with the opt-in requirement.

30 A register of subscribers supports code administrators in monitoring compliance with their code. This is particularly important if the code has a potentially high number of individual subscribers. A public register of

subscribers is also an important transparency measure to maintain the confidence of consumers and other stakeholders that a person that holds out that they subscribe to a code does in fact subscribe to the code.

31 Among the submissions, there were diverse views about the concept of a register of subscribers. This diversity emanated from the different perspectives of industry participants in the context of other proposals in CP 191, particularly those relating to codes with limited industry coverage: see paragraph 12(b). For example, if ASIC were to approve codes with limited industry coverage, respondents considered the register of subscribers from the perspective of being both a code administrator and an AFS licensee. These respondents expressed concerns about privacy and the identification of individual subscribers' personal information, and about the risk that a public register may facilitate staff poaching by other licensees. However, where the prospective code administrator was an industry association, for example, these respondents supported the need for a public, searchable register.

32 While generally supportive of the register proposal, other respondents argued that ASIC would be the more appropriate body to maintain a central register of subscribers if multiple codes were to be approved. Similar practical concerns were expressed about the potential for confusion if a consumer found information about an employee representative adviser on a code-owned register but could not verify any information about that adviser on ASIC's registers (because ASIC's registers do not cover employee representatives).

33 A minority of respondents deemed the register requirement to be unnecessary where a code was effectively administered and enforced, and that the responsibility for sharing code information should rest solely with AFS licensees and their representatives.

34 In response to our question about what information the register should include, respondents generally considered that the register should include details such as the adviser's name, the licensee's name, the licensee or authorised representative's number, the date the subscriber became bound by the code and the date they ceased to be bound.

35 Respondents also considered additional information that could be included in the register—such as whether or not the adviser was an employee representative, an authorised representative or an employee of the business, and the name of that business—which would be useful to address the potential confusion that may arise between searches on code administrator registers and ASIC's register: see RG 183.111.

36 We also consulted about amending our guidance on the frequency of independent reviews for any approved code, and on removing the upfront

- review requirement in RG 183 for a prospective code applicant under s962CA.
- 37 Many respondents welcomed the proposal to extend the timetable for independent reviews and to modify the upfront review requirement for codes approved under s962CA.
- 38 Respondents opposing these changes noted the importance of a robust consultation and development process before codes were submitted for approval.
- 39 They strongly argued that it was premature to extend the timetable for independent reviews because ASIC had not yet approved a code under RG 183 and, in the absence of experience by ASIC in overseeing code reviews—as distinct from our experience in monitoring approved external dispute resolution schemes since 1998—there was no basis on which to relax the review requirements.
- 40 The alternative argument made in relation to this proposal was to reduce the review cycle to two years for codes approved under s962CA because of the novelty of the provision and because the exemption relieves subscribers to such codes from compliance with the law.

ASIC's response

We will require administrators of codes approved under s962CA to maintain a public, up-to-date register of subscribers. This includes all persons bound by the code as an alternative to complying with the opt-in requirement. The content of the register, for the purposes of an exemption under s962CA, is set out at RG 183.111.

For ASIC to be satisfied that the code administrator is able to meet the statutory requirements under s1101A(3) and 962CA(1), and to ensure that potentially large numbers of subscribers to codes approved under s962CA are bound by and comply with the code, the code applicant must show that, at any point in time, it is able to identify the persons bound by the code in order to monitor their compliance.

A public register will facilitate transparency and will also assist AFS licensees, who may have adviser representatives that are bound by more than one code, to monitor their representatives' compliance with the law.

We will not extend the timeframes for independent reviews under RG 183, as proposed in CP 191. We will retain the current three-year review cycle at this time. However, we may reconsider extending the timing of independent reviews as we gain experience in monitoring approved codes.

We have also amended RG 183 (at RG 183.115) to make it clear that, if ASIC's monitoring or other intelligence suggests that a code

approved under s962CA is not meeting its objectives (as set out in the code and as required by s962CA), we may require the code owner to undertake an independent review before the three-year deadline falls due.

We also expect code reviews and the implementation of any recommendations to be completed within a reasonable timeframe to maintain confidence in the process and for the code to retain ASIC's approval: see RG 183.84.

We also proposed to modify the upfront review requirement for codes submitted for approval under s962CA. We have amended RG 183.113–RG 183.114 so that, if an existing industry code has been operating for more than three years without an independent review and is subsequently submitted to ASIC for approval to obtain an exemption under s962CA, we will not require it to be independently reviewed before we consider the application for approval.

However, we expect that, before submitting the code for approval, the code applicant will have undertaken the procedures relating to appropriate stakeholder consultation, as set out at RG 183.50.

Codes and AFS licensee obligations

41 Several submissions raised a number of questions about how the obligations of AFS licensees interact with codes approved for the purposes of an exemption under s962CA. These issues included:

- how the respective obligations for the fee recipient, licensee and code administrator would interact with the operation of s962CA;
- whether there was any potential conflict with the breach reporting requirements in the Corporations Act; and
- whether code subscribers also needed to comply with ASIC regulatory guides.

ASIC's response

We have updated our guidance in RG 183.74–RG 183.75 to clarify that a breach of a code does not, in itself, constitute a breach of financial services law, referred to in s912D(1)(a)(ii) of the Corporations Act, which an AFS licensee must report to ASIC under s912D(1B).

While the conduct that gave rise to the code breach might also give rise to a breach of financial services law because it is prohibited both under the law and under the code, any obligation for the licensee to report the breach under s912D will depend on whether the licensee has determined that the conduct constitutes a significant breach or likely breach to which s912D(1B) would apply, and not whether the conduct has resulted in a breach of an approved code.

More broadly, the updated RG 183 sets out standards about how we will approve codes, and our expectations of codes and code administrators following code approval. Our guidance does not include responses to all of the implementation issues and questions that have arisen.

We will, however, communicate with and, if necessary, consult with industry and code stakeholders about these implementation issues as we proceed with assessing applications for code approval.

Appendix: List of non-confidential respondents

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- Association of Financial Advisers (AFA)
 - Consumer: Joint consumer submission
 - CPA Australia and Institute of Chartered Accountants in Australia (ICAA): joint submission
 - Financial Planning Association (FPA)
 - Financial Services Council (FSC)
 - Henry Davis York Lawyers (HDY)
 - Industry Super Network (ISN) and Australian Institute of Superannuation Trustees (AIST): joint submission
 - Institute of Public Accountants (IPA)
 - SMSF Professionals' Association of Australia Limited (SPAA)
 - State Super Financial Services (SSFS)
-