The FASEA Code of Ethics – An Impossible Puzzle

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Introduction

2019 has been a very challenging year for financial advisers, with a combination of factors at play, including the FASEA Education and Exam requirements, Royal Commission recommendations, Grandfathered Commissions, Licensee closures, remediation projects and significantly increased compliance obligations. After such a challenging year, financial advisers should have been looking forward to time off at Christmas with their families to relax and energise, in advance of what will be another difficult year in 2020. That will not be possible, however, as financial advisers now face another huge challenge with the FASEA Code of Ethics scheduled to commence on 1 January 2020.

In 2017, the Federal Parliament passed the Professional Standards for Financial Advisers Bill that legislated the creation of an independent body (FASEA) who were required to develop a Code of Ethics. The Code prepared by FASEA, has the potential to fundamentally change the way financial advice is practiced. It appears that the FASEA Board have chosen to use this as an opportunity to re-write the law. As a result, the entire financial advice sector is left completely uncertain as to what will be permitted under the Code and what will not, with less than two months until commencement and no obvious way to fix this problem. With all forms of commissions and asset-based fees now in doubt, 57% of financial adviser practice income is at risk, as a result of this version of the Code of Ethics. This will impact both financial advisers, but also their clients, who might be forced to change their adviser's remuneration arrangements at very short notice.

Whilst our primary concern is with respect to how clients will be allowed to pay for the financial advice services that they rely upon, we also have significant concerns in the following areas:

- The Code puts at risk the ability to provide cost effective scaled advice by mandating the requirement for a much more comprehensive understanding of the client's full current personal circumstances, broader family circumstances and likely future circumstances. The outcome of this will be a reduction in both access to financial advice and the affordability of financial advice.
- Standard 3 on conflicts of interest is completely inconsistent with the long established requirements to manage and disclose conflicts of interest. Conflicts are very common in financial services and exist in ways that do not disadvantage clients. They cannot be completely eradicated, and an outright ban would be entirely impractical.
- A ban on the receipt or provision of referrals for a benefit, including any expectation of reciprocal referrals, will fundamentally challenge existing practices and impact upon the flow of new clients for many businesses that rely upon referral arrangements.
- The onerous requirements relating to incomplete information and informed consent will make it very difficult to advise clients who for personal or cultural reasons do not want to provide all their personal information, or for whom they do not wish to or do not have the capacity to fully understand every aspect of the services that are being provided, or the remuneration or the implications of the advice.

- The requirement to obtain a new consent from existing clients to reconfirm ongoing service arrangements and ongoing remuneration as soon as practicable after the commencement of the Code, will be a costly exercise, duplicating existing client opt-in processes and previous authorisations. This is also unnecessary for grandfathered commission clients and life insurance only clients.

Our Expectations of the Code of Ethics Guidance

The Code of Ethics was issued on 11 February 2019, and we immediately identified major concerns with the changes to Standard 3 and a complete ban on conflicts of interest. We discussed our concerns with the Minister at the time. In their announcement on 11 February, FASEA promised to shortly issue guidance. FASEA encouraged us not to read the Code too literally and promised that our concerns would be addressed when the guidance was released. To this end, we had consultation meetings with FASEA on 24 May 2019 and 4 July 2019, during which they committed to consulting with the professional associations before the release of the final guidance. An action that they did not take.

We were seeking much greater certainty through the guidance. We wanted to see a clear explanation of the situations where financial advice would be compliant. We wanted certainty that commissions on life insurance advice would be permitted. What the guidance provides is no certainty, in that it lacks any explanation of where financial advice will be compliant, but rather identifies cases where potentially it might not be compliant. This has meant that we now have important additional areas of uncertainty with respect to brokerage, asset-based fees and commissions.

The Implications for Practice Income

Conflicts of Interest - FASEA Media Release – 18 October 2019

The 18 October 2019 FASEA media release on the Code of Ethics guidance, included the following statements:

> "The making of the Code and changes to education and training standards, reflect community expectations that the provision of professional advice be centred on serving the best interests of the client free from any conflict."
>
> "FASEA's efforts have been targeted at realising this expectation within the context of the Act. To that end and following extensive consultation with key stakeholders, the Code of Ethics was made in February 2019."

The statement above about financial advice being free of any conflict is a very broad statement. This leaves no room for any uncertainty with respect to FASEA's position. There is an equally fundamental statement on page 7 of the guidance document:

> "It is important to note that the mere fact that a conflict is permitted under another part of the law does not offset your duty to act in the best interests of your client free from any conflict of interest or duty."

The statement in the media release asserts that there is a community expectation that the provision of financial advice should be free from any conflict and that FASEA were targeting this expectation. It is not obvious to us, other than the fact that it was mentioned in the Royal Commission final report, that it is a community expectation that all financial advice be free from any and all conflicts. It is important to note that the ban on any conflict of interest or duty was not part of the November 2018 consultation version of the Code, and was only added in the final version of the Code of Ethics, when the legislative instrument was released on 11 February 2019. Despite being required by the Corporations Act, FASEA never consulted on this requirement to avoid all conflicts.

Standard 3 and the statements in the media release seem pretty clear, in that FASEA wants to ensure all conflicts are removed from financial advice. It is most probable, however, that they do not fully understand what this means or the unintended consequences, which we address below in our detailed analysis of Standard 3.

These statements need to be read in the context of what Stephen Glenfield said at the Senate Estimates Hearing on 23 October 2019:

> "No. If you read the preamble to standard 3, it makes it clear that FASEA is not banning any particular form of remuneration but that the remuneration must meet the provisions of the code, which would include being in the best interests of the client, representing fair value under standard 7, and in accordance with the other provisions of the code. There is no blanket ban on any particular form of remuneration."

Despite the above statement, there is a lack of examples of permitted forms of remuneration and neither is there any statement that any form of remuneration is definitely permitted and there are very material warning signs with respect to brokerage, commissions and asset-based fees. We believe that it is reasonable for financial advisers to expect a much greater level of certainty, and after waiting 8 months for the guidance document, this certainly has not been delivered.

In our view, this statement at the Senate Estimates hearing simply adds to the uncertainty, in suggesting that there is no blanket ban on any form of remuneration, which seems inconsistent with the Code's ban on any conflict of interest. It is further confused by the suggestion that the form of remuneration needs to be in the best interest of the client. The advice needs to be in the best interests of the client.

Potential Impact on Practice Income

Investment Trends have recently completed a survey that included the breakdown of financial advice practice income in 2019, which is set out in the following table:

Revenue Type	% of Practice Income	Implications
Grandfathered Trail Commissions	6%	At Risk
Life Insurance Commissions	23%	At Risk
Fee for Service - Asset Based	28%	At Risk
Fee for Service - Hourly rate	3%	
Fee for Service - Fixed Fee	37%	
Other	3%	Unknown
Total	100%	

Commission income and asset-based fees represent 57% of practice income and this is all at risk as a result of Standard 3 of the FASEA Code. Other income may be at risk if it is in breach of any of the standards, including some of the conflict of interest issues that we have addressed below.

What Must Happen

One positive statement in the 18 October media release, is the following recognition:

> "The Code is a living document and subject to change, as required."

We have clearly reached the point, where it is obvious to all, that change is required and FASEA needs to deliver on this change to make the Code workable. Standard 3 needs to be fundamentally changed, with the ban on conflicts of interest removed and a number of the other standards needing material change. In the absence of this, financial advice practices have no confidence that they will be able to continue to operate in 2020.

Analysis of the Standards and the Code of Ethics Guidance Document

In the remainder of this document we have completed a detailed assessment of each of the Standards, the preamble for the standard in the Guidance document and the examples. This has been prepared with the purpose of generating debate and contributing to a greater level of understanding of the implications of these standards, when implemented in the real world.

We have sought to assess the examples and whether they provide a useful insight into the application of the standard. In many cases, it is our view, that the examples provide little insight, as either the conduct is obviously wrong, or they just create more confusion.

Standard 1 – Act in Accordance with the Law and not try to Avoid or Circumvent their Intent

Example 1 demonstrates a case where the advice is clearly flawed, however, it is unclear whether the clients were in agreement with an execution only basis, and it seems to be inconsistent that the property developer had agreed to pay for the preparation of a Statement of Advice, however the adviser suggested doing it on an execution only basis. One of the key issues in this example, that was not mentioned, is the lack of diversification. They already have a home and an investment property, however, are now considering purchasing another property through an SMSF. There is no diversification.

The blanket statement that the adviser should cease the relationship with the developer is understandable given the basis of this arrangement, however, to what extent might this expectation be extended to other referral arrangements which have very different models. There is also a statement, at the end, that Standard 3 requires that he refer out the SMSF component of the advice. How broadly might this conclusion be applied to other situations?

Example 2 on wholesale clients fails to clearly set out that the clients have at least $2.5m in net assets as there is no statement with respect to the size of any mortgage on the house. In the middle of the example, there is a statement that "As Donna is a wholesale client, Wallace did not prepare a statement of advice, nor does his advice need to comply with the best interests' duty or the Code of Ethics". This is contradicted by the statement at the top of page 12 that "As he is a person authorised to provide personal advice to retail client, he is bound by the Code". The implications of the Code of Ethics, for wholesale clients, needs to be clarified.

Standard 2 appears to challenge the application of the Wholesale test in the absence of evidence that the client is an experienced investor. This appears to be another case of FASEA seeking to re-write the law.

Example 3 discusses a situation where a client has the option to move from a grandfathered commission arrangement to a new post FoFA product. The example fails to explain that an adviser in such a situation would need to add a new ongoing fee arrangement, in lieu of the grandfathered commission payment, and that this new fee may significantly exceed the existing grandfathered commission payment, due to the additional costs and processes involved in an adviser service fee arrangement. This is a fundamental gap in the example. It is also the case that there is no explanation of whether a move to the new product might present a complication with either an exit fee, CGT liability or the risk of losing insurance. Neither is there any discussion of the cost of obtaining advice to move from the existing product to the new product. Also, there is no discussion on whether the client might be better to stay in the existing product and have the grandfathered commissions and a share of volume bonuses rebated to them.

It is further suggested that the intent of the FoFA laws was that advice transition over time to a fee for service arrangement. There is no evidence that this was the intent of the FoFA Bill and therefore suggesting that failing to transition is a breach of Standard 1, is totally wrong. Would this analysis be different if it was demonstrated that the advice fees under an adviser service fee arrangement would ultimately cost the client more?

The discussion in the other considerations box at the bottom of page 12 suggests that the adviser would need to "not only consider the upgraded version of the existing product, but also compare the market for similar products and to select the most appropriate product". This statement introduces the concept of the best product, which is not a requirement of the law. Regulatory Guide 175 requires that the adviser demonstrates that the client would be in a better position.

Despite all the above, it seems to be suggested that avoiding recommending the new product would be a breach of both Standard 2, due to a lack of integrity and Standard 3. The discussion on Standard 3 at the top of page 13 seems to suggest that the adviser must avoid a conflict of interest and duty that arises as a result of the existence of grandfathered commissions. This is an overly simplistic example, that fails to adequately explain the full situation.

Standard 2 – Act with Integrity and in the Best Interest of Each Client

Whilst we have always supported the principle of this standard, our concern is with respect to the deeper implications of the work required to understand the investigation of the client's broader, long-term interests and likely future circumstances. The discussion at the bottom of page 13 requires the following:

> "This means that you will need to work out, and, if necessary, help the client to work out what the client's objectives, financial situation, needs, interests (including long-term interests), current circumstances and likely future circumstances are.

To comply with the ethical duty, it will not be enough for you to limit your inquiries to the information provided by the client; you will need to inquire more widely into the client's circumstances."

Our concerns with this are as follows:

- Not all clients are willing to share their full details at the commencement of a financial advice relationship. This can be more pronounced in certain ethnic groups.
- For lower income clients, or those who are less prepared, the cost of the pursuit of this additional information may mean that they are no longer economically viable to advise and service.

The discussion on the top of page 14 has the effect of removing the Best Interests duty safe harbour. This has not been adequately explained and simply adds additional confusion for no apparent benefit.

Page 14 also includes a statement about "treating all clients fairly, as between themselves" and "so that each client has a fair share of your attention, skills and time". How is this concept of 'fair' to be assessed? Over what period is this to be assessed? Some clients have an ongoing arrangement with a financial adviser so that they can quickly get access to financial advice when they really need assistance. They may place less importance on a regular meeting. How can an adviser be certain that they are meeting this requirement? Are lawyers, with clients who have retainer arrangements, required to ensure that clients are treated fairly?

Example 4 is so clearly poor advice that this is actually of little benefit and does not demonstrate or explain any key points.

It is arguable that the limited scope of advice in Example 5 is simply to increase the life insurance cover for Ivan. It is questionable as to whether excluding his existing cover through his superannuation fund, is really a matter of scope. It is a mandatory requirement of providing life insurance advice that the existing cover is considered. The other considerations section at the bottom of page 16 suggests that the adviser has a business model conflict, however, fails to explain what this conflict is. It might be implied that this is because the client's super fund is not on her approved product list. This however fails to take into account that most licensees have a non-approved product process and also that there is an obligation for an adviser to consider the existing product. In the absence of further explanation, it appears that the conclusion is that the existence of a commission being paid on the recommended insurance poses a conflict of interest and that an adviser should avoid the conflict and decline to advise the client. Once again this just creates confusion. This is the only example that is directly related to life insurance and leaves the impression that, conflicts of interest with respect to commissions on life insurance, must be avoided.

Standard 3 – Not Advise or Refer Where There is a Conflict of Interest or Duty

Conflict of Interest is a black and white concept. It either exists or it does not. There is no concept of materiality in whether it exists. The materiality may impact the way it is managed. We struggle to see how this standard can be fixed by guidance that provides interpretation, that is not binding in a court of law. The Code can be used by the Courts and by AFCA.

Section 912A(1)(aa) of the Corporations Act requires that an AFSL:

> "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”

This is the legal obligation, which is to manage conflicts of interest. ASIC Regulatory Guide 181 sets out their guidance for licensees in the management of conflicts of interest.

RG 181.15 defines a conflict of interest as follows:

> “For the purposes of this policy, conflicts of interest are circumstances where some or all of the interests of people (clients) to whom a licensee (or its representative) provides financial services are inconsistent with, or diverge from, some or all of the interests of the licensee or its representatives. This includes actual, apparent and potential conflicts of interest.”

RG 181.20 sets out the core expectations:

> “The three mechanisms that licensees would generally use to manage conflicts of interest are:
> (a) controlling conflicts of interest;
> (b) avoiding conflicts of interest; and
> (c) disclosing conflicts of interest.”

RG 181 does not require an outright avoidance of all conflicts of interest.

Financial advisers want a level of certainty and they want time to prepare for any changes that they might be required to make. They have neither with respect to Standard 3, nor the guidance on Standard 3.

The preamble on Standard 3 introduces a number of new concepts, each of which add to the current confusion.

Whilst the statement is made that this Standard refers to actual conflicts of interest, page 7 of the guidance also makes the point that advisers should be alert to the challenges posed to professional integrity by potential and perceived conflicts of interest and duty. Actual conflicts is not defined or explained. Thus, the statement about actual conflicts lacks clarity and meaning.

Conflicts of interest largely arise as a result of the following factors:

- Business association – related businesses
- Personal association
- Ownership association
- Employment or authorisation association
- Remuneration

Business Association – Related Businesses

Example 7 discusses a referral to an associated business, and seems to suggest that based upon an extensive list of criteria, this would be OK where the ultimate advice was in the best interests of the client and the adviser only benefited in terms of a share in the profits of the associated company. This might seem reasonable for mid-size companies, where there is a specific divide of responsibilities between the different entities in a group, however this is not always how it works in practice. In the case of smaller businesses, the financial adviser who is providing the SMSF advice, might also be the same person who is providing accounting or administration services in the accounting entity. Thus, the benefit is more than just a share of the profit of the associated business. Would this small business scenario fail to comply with the requirements of the Code?

Referral arrangements are a very important part of the financial advice sector and something that is intended to work in the best interests of clients, as they are getting a referral from someone that they trust and the party that they are being referred to is known and they are getting a warm handover and are more likely to have access to the adviser for addressing questions.

What has been proposed is likely to mean that rather than referring clients, advisers will need to bring everything in-house, or to set up joint ventures with their referral partners.

Rather than putting in place what appears like a virtual ban on referrals, it would seem more sensible to set out what referral arrangements are inappropriate.

Personal Association

There are many financial advisers who have either family members or friends who work for financial product providers and where they recommend products from that product provider, there is a risk that this could be deemed to be a conflict of interest. This might depend upon the role that the family member or friend plays, and whether the utilisation of products from that product provider will have any remuneration impact upon the family member or friend. This product recommendation may be in the best interest of the client, however it does not change the reality that it could be a conflict of interest and therefore under Standard 3 they would be prevented from products from that product provider.

Ownership Association

This is a difficult one. If an adviser has a direct or even indirect ownership in a listed company, then they have a conflict of interest in recommending that company. This might include the ownership of shares either in their own name, or through a managed account. It also includes shares owned by family members. It could also include shares owned indirectly via a managed fund or a superannuation account. It gets even more complicated when you look at it in terms of owning shares in a financial institution. You would not only have a conflict in recommending an investment in that company, but also in recommending any products that are produced by that company. So, for example, an adviser who owned shares in Westpac, would have a conflict of interest if they were to recommend to a client that they purchase shares in Westpac, or an investment in a BT super or investment product or to obtain insurance via BT Life Insurance. The fact that the purchase of these shares or products are unlikely to have any impact on the share price of Westpac, does not change the fact that it is a conflict of interest. There is no discussion in the guidance on the issue of ownership of shares.

Managed accounts provide beneficial ownership of the underlying investments; however, investment decisions are made by the investment manager. What would happen if an adviser had an investment in a managed account and the manager invested in a new company that the adviser had previously recommended to their clients? They would now have a conflict of interest and would no longer be able to give any advice with respect to that company. This would include not issuing buy, sell or even hold recommendations.

Employment or Authorisation Association

It seems that the recommendation of a product provided by an employer or by an associate of the licensee has been addressed in the Explanatory Statement in paragraph 38:

“You will not breach Standard 3 merely because you recommend to a client financial products offered by your employer or principal. However, you will breach Standard 3 if a variable component of your remuneration depends on the amount or volume you recommend of those products, because your interests will or may conflict with your duty to act in the client’s best interests.”

Although the explanatory statement was released on 11 February 2019, the reference to the variable component of remuneration was probably not understood at that time. It appears that it has now been more specifically addressed as part of the Guidance document. On the surface of it, the statement about the recommendation of an inhouse product seems inconsistent with the requirements of Standard 3 to avoid all conflicts.

Page 17 of the guidance also provides some context. The discussion on page 17 introduces a number of new terms and concepts. For example, what does “duly remunerated” mean? What does “sole context within which you practice mean”? What is an “ancillary product and service”? What does “merely incidental” mean?

It appears to suggest that recommending an ancillary product or service may be acceptable, if it is limited to a profit share and the product or service is “merely incidental” to the adviser’s “dominant purpose” and that it will “confer value on the client that is equal to or greater than that offered by any other options”. It is unclear how any of this could be argued or documented.

Putting aside the complete lack of clarity on what an ancillary product and service is, this exemption also opens up a much broader challenge in that the second bullet point requires that the product/service confers on the client, value that is equal to or greater than that offered by any other option. This is particularly challenging. Rather than putting the client in a better position, as required by Regulatory Guide 175, this requires that the adviser recommends the best product. How do they assess which is the best product? It is being assessed in terms of the value to the client, and value to the client is a difficult concept to assess, as everyone has different ways of determining value.

Remuneration

In terms of life insurance, it is clear that life insurance commissions are deemed to be conflicted remuneration, otherwise there would be no requirement for it to be given an exemption under the conflicted remuneration provisions in section 963B(1)(b). Whilst the statement by Stephen Glenfield at the Senate Estimates hearing that there is no blanket ban on any form of remuneration, might suggest that commissions on life insurance were not automatically prohibited, it is difficult to conclude otherwise when you look at the Code of Ethics and the guidance. There is little discussion of life insurance commissions in the guidance, other than Example 5, which concludes that the adviser should have avoided the conflict.

It seems that the key potential grounds for either capture or an exemption from the Code, for issues such as asset-based fees and life insurance commissions, sits with the following paragraph at the bottom of page 17.

Other sources of ‘variable income’
You will breach Standard 3 if a disinterested person, in possession of all the facts, might reasonably conclude that the form of variable income (e.g. brokerage fees, asset based fees or

commissions) could induce an adviser to act in a manner inconsistent with the best interests of the client or the other provisions of the Code.

This opens up a number of questions including what is a "disinterested person". What does "reasonably conclude" mean and what are the implications of the use of "could induce"?

In terms of life insurance commissions, the key driver of conflict is the level of cover that is recommended, as the commission is directly related to the amount of the premium, which is directly influenced by the level of cover. What one adviser thinks is the right level of cover, may be more or less than what another expert thinks is required. If we take the example of a married couple, with one non-working partner and with two children in private schools, the recommended amount of term life insurance will depend upon some key assumptions, including the size of the mortgage and whether after the death of the insured, the non-working partner might go back to work or not and whether the children will stay in private schools. It might also depend upon whether other assets could be sold to fund future living expenses. In addition, what assumptions are made about investment earnings. Put simply, an adviser might have a methodology for working out how much insurance they believe is required and acting on that basis, but then another party may assess this as an excessive level of insurance. How can an adviser ever feel totally comfortable that they will pass the 'disinterested person', 'reasonably conclude' and 'could induce' tests?

With asset-based fees, one of the common questions will be, whether a client should use surplus cashflow to make an additional salary sacrifice contribution into super or alternatively to pay down their mortgage. This will generate a diversity of views, however an assessment of it will require detailed consideration of the current and future interest rates on the mortgage, expected further movements in the value and earning of the superannuation fund, and tax implications of salary sacrifice contributions versus paying down the mortgage. How can an adviser ever be certain that a disinterested person in the future, will not make an assessment that a recommendation to salary sacrifice into super, as opposed to paying down a mortgage, was induced by the presence of asset-based fees?

This standard is incredibly problematic. Despite our deep-seated concerns about this standard, we had hoped that the guidance would provide a sensible pathway forward and create greater certainty. In our view, the guidance has not provided any additional clarity and has now actually made it more uncertain.

Despite a page and a half of preamble and four pages of examples, we remain deeply concerned about what forms of remuneration are permitted and believe that the current level of uncertainty is totally unacceptable.

Referrals

One common referral arrangement is with respect to the payment of a fee by an adviser for the receipt of a referral from an accountant. Where a financial adviser pays a referral fee to an accountant, it is difficult to see where the conflict of interest is. In what way are they conflicted?

Any previous assumption, that a payment of a fee for a referral would not be impacted by the FASEA Code of Ethics, was challenged by the following statement in Example 8 on page 20:

> "This means she can neither receive nor provide any benefit, whether financial or otherwise in relation to either the receipt of, or the making of client referrals."

This example then goes on to make the following statement:

> "Bev, who is bound by similar ethical requirements under Accounting Professional Ethics and Standards Board (APES) standards, agrees."

The payment of referral fees to accountants is very common, so I am not sure what the basis is for this statement that the accountant is also bound by similar ethical requirements under the APES standard. A quick look in APES 230, includes the following reference to referrals:

> "Third Party Payments excludes non-recurring fixed referral fees received by a Member as a result of referring a Client to another service/product provider provided that they are not Commissions and are disclosed to the Client by the Member."

Clarification is required on the issue of the payment of a fee for a referral. In our view, it does not appear to constitute a conflict of interest and we cannot see that it is prevented by APES 230, provided that it is a flat fee that is non-recurring.

There are some financial advice practices that are highly reliant upon referrals from accountants. This requirement is likely to have a huge impact on their businesses and they are particularly concerned.

Often the party making the referral is required to do a material amount of work prior to the referral being made. This might be very beneficial for both the party receiving the referral and for the client themselves. In a world where an adviser is banned from receiving any benefit for making referrals, then this preliminary work would either not be done or it would need to be done for no reward. The ban on referrals is going to lead to a reduction in the number of referrals, which will ultimately be disadvantageous for clients.

Some risk insurance advisers will refer to another provider for health insurance, as part of the fact find process. Consistent with APES 230, in our view a flat referral fee should still be payable in this circumstance. Some life insurers also provide health and wellness programs that are ultimately beneficial for the client as it may lead to improved health and reduced life insurance premiums. The payment of a flat referral fee for such an arrangement should not be prevented.

Conflict of Duty

There are also a couple of examples of conflicts of duty that might fundamentally change some existing client arrangements:

- **Intergenerational Clients.** Where an adviser provides advice to both the parents and their children , there is the inevitable risk that there will be a conflict between the adviser's duty to the parents, as opposed to the children. This might be the case when the adviser is giving estate planning advice to the parents. This is not entirely dis-similar to the example on divorce on page 18 where there is a prospect that the interests might diverge.
- **Advising family members.** When an adviser provides advice to their own family members, then it could be argued that they have either a conflict of interest or a conflict of duty. Any discussion with respect to estate planning or advice for a parent to better budget could be viewed through the lens of a conflict.

Often intergenerational advice is provided to the children at the request of the parents. It is difficult to see why this might need to be avoided in the future. Often advice to family members is provided for free or at a discounted price. It seems that banning this is simply impractical and unreasonable.

Other comments on Standard 3

In our view, the use of the word “churning” in the guidance for Example 6 is unnecessary.

The requirement in Example 7 to set out why the fees and charges from an associated business are fair and reasonable and represent value for money is a significant challenge. Should this be required just to provide a referral?

Example 8 discusses the implications for cross referral arrangements. This is unnecessarily complex and will ultimately be costly to implement. This also fails to take into account the implications for regional and remote locations, where there might only be one referral option in the town. It is difficult to see how this is in the best interests of clients, as they simply want to be referred to an accountant who their adviser trusts. If you are forced to give them three options, then this is much less helpful. This is taking the removal of conflicts to a level that is totally counterproductive for clients. The prohibition of referrals, on the basis of the expectation of future reciprocal referrals, is unnecessarily restrictive.

The 6.5% stamping fee in Example 9 seems completely excessive. We are not aware of the existence of stamping fees that are anywhere near this level. This seems like a wild exaggeration for the purpose of adding emphasis to a point. What evidence does FASEA have that this level of stamping fees actually exists? The suggestion that a stamping fee might be declined by the broker, neglects the fact that this means that it would be retained by the company and therefore be of no benefit to either the client or the stockbroker. It is difficult to see how this would be in the best interests of the client.

Standard 4 – Act Only with the Client’s Free, Prior and Informed Consent

Whilst we firmly support the objective of obtaining a client’s free, prior and informed consent, it must be appreciated that there are a reasonably large number of clients who do not have the capacity or the desire to fully understand what the financial adviser is doing for them. This might be the case with older clients, particularly those who have lost capacity (including where an Enduring Power of Attorney has been appointed). An adviser relationship, based upon the fact that the client totally trusts the adviser, is not ideal, however the alternative might be that the adviser is forced to walk away from the client. This is unlikely to be in the best interests of the client. How should advisers treat clients who have a disability or who have language difficulties? What is required for a widow or a widower where their spouse had always looked after the finances? The examples should have addressed these issues.

Whilst it is agreed that full understanding by the client is the clear preference, the Code fails to consider the consequences where this is not possible.

In our discussions with FASEA on 24 May and 4 July we made specific reference to our concern about what was required with respect to the statement in the Code that “If required in the case of an existing client, the consent should be obtained as soon as practicable after this Code commences”, particularly when the Explanatory Statement appeared to suggest that this was mandatory. The guidance provides no discussion on the requirement to obtain consent from existing clients or what “as soon as practicable after the Code commences” actually means. Clients have already provided consent. We do not support any requirement to obtain client consent from existing grandfathered commission clients or insurance only clients.

Example 11 is clearly poor advice and thus it is of little value. In the other considerations box, there is a statement that where an adviser has a client that is referred to for general advice that it is important that they conduct sufficient investigations of the client's circumstances. This creates another issue, as the knowledge of their personal circumstances, makes the provision of general advice problematic.

It needs to be noted that the provision of an education program as discussed in Example 12, will be costly. Charging a high fee for the education of the client, may open the adviser up to challenge as to whether they have acted in the best interests of the client.

Standard 5 – Best Interests Duty, Appropriate and Understanding

Whilst it is difficult to disagree with this Standard, it is obvious that the requirement to take into account the client's broader, long-term interests and the client's likely future circumstances will add to the cost of providing financial advice. It will also make it more difficult to provide scaled advice. The requirement for detailed engagement with and assistance to the client will also impact upon the cost and complexity of providing financial advice.

All of these additional requirements impact access and affordability of financial advice for everyday Australians.

Example 14 raises some interesting questions with respect to what action an adviser should take where they disagree with the actions of their licensee. It seems that simply raising concerns with a licensee about Statements of Advice templates, that are not clear, concise and effective does not remove the obligation on the adviser to deliver advice in this form. The proposal seems to be that the adviser will add additional explanation to assist a client to understand. In our view this may not be effective and may result in advice that is not compliant. The example does not set out the licensee's response to the intervention of the adviser. This seemingly does not address the problem.

With Example 15, it would seem that a war widow will be receiving a Department of Veterans Affairs pension rather than an Age Pension. This example comes down to the meaning of "for the immediate benefit of her grandchildren after she dies". There is not enough context around the specific needs of the client. It is not clear how old the client is and what her expected remaining lifetime might be. Investing in a growth fund, may not be inappropriate, if the client expects to live for a number of years and wants to invest for growth to provide an inheritance to her grandchildren that they can choose to continue to hold or to cash in. It is not clear whether the poor investment performance is due to an overall decline in the market, or issues related to the specific fund. The fact that the investment performs poorly, should not automatically suggest that the advice was inappropriate. It is not obvious that the adviser has failed to clearly explain the risks, as this is included in the SoA and the verbal discussion of risk has not been set out.

With Example 16, there is a clear issue with the influence that arises from the referrals from the property developer, and this clearly sets up a key risk for clients. From the brief description of the example, there is insufficient explanation to clearly demonstrate that the adviser has failed to establish that the SMSF recommendations are in the best interests of and appropriate to each client.

One of our concerns with Example 17 is that the time share salesperson is described as a financial adviser. If they are only authorised to provide financial advice on time share schemes, then they are not entitled to use the term financial adviser. FASEA should know that. It is also unclear if the sales representative provides the client with an SoA. The conclusion, in the other considerations section, is that the adviser has a conflict of interest and duty in breach of Standard 3. The nature of the conflict of interest and duty is not articulated. There is a reference in the example to a payment of a commission. Should we assume that the simple prospect of the receipt of a commission, is the basis for the statement with respect to a conflict of interest and duty in breach of Standard 3? This requires further explanation to assist in understanding whether it means that any commission represents a breach of Standard 3.

Standard 6 – Broader Effects and Long-term Interests and Likely Circumstances

Our concern with Standard 6 is the additional cost involved with the requirement to consider the broad effects of the advice and to actively consider the client's broader, long-term interests and likely circumstances. The preamble discusses the requirement to consider the implications for family members. In a complex, blended family, with multiple structures, this might be particularly challenging and costly to implement.

Example 18 provides little insight, as this is reasonably obvious that recommending the establishment of an SMSF to purchase a property with a limited recourse loan just five years prior to retirement, may not be suitable. This is a medium-term consideration and is a direct factor that is quite obvious. This does not adequately demonstrate 'broad effects' or 'likely circumstances'.

Example 19 relating to an older lady with little financial knowledge in an SMSF, concludes with a statement "Now she is left in a position where she has to wind up the fund in order to get retirement assets into a not-for-profit pension fund." Whilst it is apparent that an SMSF is unsuitable for this client, it is not apparent to us why this example needs to demonstrate a preference for one type of pension fund over another. This is surely not necessary.

Standard 7 – Free Prior and Informed Client Consent to Remuneration

In our discussions with FASEA on 24 May 2019 and 4 July 2019, we made specific reference to our concern about what was required with respect to the statement in the Code that "If required in the case of an existing client, the consent should be obtained as soon as practicable after this Code commences", particularly when the Explanatory Statement and the guidance documents both appearing to suggest that obtaining existing client consent is mandatory. The guidance provides no discussion on the requirement to obtain consent from existing clients or what "as soon as practicable after the Code commences" actually means. Existing clients have already provided consent by signing the SoA and the application forms. We strongly oppose the need to obtain this existing client consent for grandfathered commission clients and life insurance only clients.

In terms of the statement in the Code that "Except where expressly permitted by the Corporations Act 2001, you may not receive any benefits, in connection with acting for a client, that derive from a third party other than your principal " the Corporations Act specifically refers to exemptions for life insurance commissions and certain non-monetary benefits. It does not, however, make any reference to referral fees. It therefore seems that the condition that only third-party payments that are specifically permitted in the Corporations Act sets an unbalanced test. It does not automatically prove that all other forms of payment are wrong, or are not in the best interests of clients.

This standard requires that all benefits paid to the adviser are fair and reasonable and represent value for money to the client. There is no explanation of what this might require in the preamble. In our view, it is critical that this requirement for benefits to be fair and reasonable and represent value for money to the client, must be explained in detail.

Example 20 talks about an adviser providing the client with multiple consent forms for the client to sign in order to consent to proceeding with each stage of the advice process. We question the expectation that is being created by this example. Why isn't it adequate for the adviser to get approval to prepare a Statement of Advice and then to separately get approval to implement the Statement of Advice? This should only be two stages, not multiple stages.

Example 21 is of very limited value. It is obvious that an adviser cannot get clients to sign an incomplete form. The adviser should get the client to consent to the preparation of an SoA for an agreed fee. The fees for the implementation of the recommendations in the SoA should be clearly set out in the SoA and subject to separate client consent via the Authority To Proceed page. This further discussion of a range of authority forms is only causing further confusion about what an adviser is expected to do.

Example 22 is another example based upon a client investing in investment properties. It is unclear to us why there is so much focus upon investment properties, particularly when each of them seem to demonstrate a lack of diversification, which unfortunately is not the subject of any comment. It would seem that a referral to a real estate buyer's agent is an uncommon outcome and therefore it is unclear to us why this would warrant being included as an example in the guidance document. When FASEA have the chance to include examples that are directly relevant and might clearly set out the expectations, why have they chosen to use examples like this?

Standard 8 – Complete and Accurate Client Records

It is our view, that this standard required some clarification, as this does not reflect financial advice practices and processes. Ultimately, under the Corporations Act, it is the licensee who is responsible for the management of complaints and they take the lead in ensuring they retain copies or access to client files. It is also the case that the financial advice sector has a combination of soft copy files and hard copy files, which creates additional complexity. Further, an employed adviser is not able to maintain the client records once they have left an employer and neither can an authorised representative adviser, who sells his business, retain a copy of the client files. In terms of a financial adviser who operated on the basis of an electronic financial planning system (i.e. paperless office), they would need to retain access to the electronic financial planning system to be able to continue to access client files. Once an adviser has sold their business, they are unlikely to retain access to the financial planning software.

It is unclear what the key message of Example 23 is. It is possible that this might be implying that financial advisers need to transition from hard copy files to soft copy files. This requires clarification.

Example 24 provides some clarity with respect to the obligations of an employed financial adviser, which is not reflected in the Standard. This example suggests that the adviser will review all client files before they leave and that they will provide a signed statement confirming that they have handed over all client records to the licensee. If they have notified that they are going to another firm, then it is quite likely that the existing firm will not let them review the existing client records. This seems to set up unrealistic expectations. What is required in the event that an adviser is immediately retrenched or terminated for any reason?

There is no example to explain the record keeping requirements when a financial advice business is sold. This standard has good intent, however in the real world, there are a number of complications and complexities, and what is required by financial advisers remains uncertain.

Standard 9 – Advice and Products Provided in Good Faith and with Competence; Not Misleading nor Deceptive

Our previous concern with this standard is the expectation that financial advisers might be responsible for misleading or deceptive disclosure and conduct by a product provider, when the adviser had undertaken sufficient investigation of the product before recommending it.

Example 25 presents a major issue. The licensee has undertaken research on the product and concluded that it is suitable for an investor with a moderate risk profile, however the adviser has done their own investigation and has concluded that the product is only suitable for a client with an aggressive risk profile and surplus cashflow. The difference between moderate and aggressive is very material and this suggests that the research is unreliable. It is unclear what is driving such a large difference. In our view, until this issue is addressed, it would seem inappropriate to recommend the product.

Example 26 is of questionable value as there are such fundamental differences between the marketing of the product and the reality of the product. This seems like some remarkable case study drawn from the worst of the GFC product crashes. The relevance to today, particularly given the recent introduction of legislation on design and distribution obligations and product intervention powers, is highly questionable. The heading is ‘Fixed term investment’, which is different to it being marketed as a ‘fixed interest product’. This is an important difference. The detailed description of the features of the product is so very different from the marketing description. How would it be possible that this fund would be classified as a defensive asset? It is not clear what point is being made by this example. In terms of the comment about monitoring the underlying fund assets and the fund’s internal gearing ratio, this information would not be readily available and to some extent it is missing the point, as the stated features are clearly inconsistent with the marketing statement.

The suggestion is that the advice issue in Example 26 relates to competence, although it is arguable that it merely demonstrates a lack of diligence. There is reference to it being misleading and deceptive which is a reasonable claim, on the basis of what has been presented, however this is misleading and deceptive on the part of the product provider. It is less clear that such a claim could be made with respect to the financial adviser. There are no examples with respect to ‘good faith’.

Standard 10 – High Level of Relevant Knowledge and Skills

We have always had a concern with respect to how a new adviser might commence the provision of a particular type of advice, or how an existing adviser may expand to a new line of service. For example, an adviser who has not previously provided SMSF advice, may complete an accreditation course on SMSFs, and then seek to provide advice on SMSFs. The completion of a course, in the absence of practical experience, does not prove that the adviser has the required high level of knowledge and skills. It was therefore thought that the utilisation of a coach or mentor might have been the means to commence operating in a new area, such as SMSFs. The following statement in the “Competence” section on page 8 increases the level of uncertainty with respect to how an adviser might commence in the provision of advice in a new line of service:

> "Whilst it may be possible to supplement your professional competence by accessing the expertise of others, <u>the duty of competence is ultimately personal and cannot be outsourced to others</u>. If you don't possess the particular competencies required to assist your client, in accordance with other ethical requirements in the Code, <u>you must refer your client to another professional</u>."

We do not know how a new adviser, or an existing adviser seeking to extend their services, can provide advice whilst complying with this requirement. How do advisers expand their capability, particularly in small practices, if they are expected to have the relevant knowledge and skill before they start?

Example 27 uses some strange choices of wording such as "Like Vernon, the plan has survived a number of attempts by new owners to shut it down" and "prevent Vernon from reaping the rewards of his years of toil". Is this suggesting that his employer was trying to shut Vernon down? Ultimately this is a totally ridiculous example as it lacks adequate detail and breaches the fundamental requirement to carefully consider doing anything with respect to defined benefit superannuation funds. The suggestion that she recommended moving to a retail fund (why select retail?) on account of Vernon's anxiety is confusing, at best. There are significant additional obligations that apply with respect to product replacement, which she has completely ignored. This is clearly a breach of the law. The relevance to the Code of Ethics is in many ways, lost. This does not address the requirements of a high level of relevant knowledge and skills. This demonstrates no knowledge or skills.

Example 28 relates to a new adviser who has chosen to use the supervision of an experienced adviser, in order to ensure that they have access to the required skills to provide complex financial advice involving a number of detailed issues. This seems like a sensible and workable solution; however, it is completely inconsistent with the paragraph from page 8 with respect to "Competence" as highlighted above, that precludes any form of outsourcing and suggests that the client should be referred to another adviser. This inconsistency needs to be addressed.

This is another standard where the examples do not provide the necessary level of clarity and do not address our key concerns.

Standard 11 – Cooperation with ASIC in any Investigation

This is a straightforward standard that is a fundamental obligation and should not actually be required. It is difficult to oppose it. Example 29 provides no clarification as this demonstrates clear compliance with this standard. Example 30 is the complete opposite as it obviously demonstrates a lack of cooperation. Neither of these examples demonstrate any value. The examples need to provide insight, not state the obvious.

Standard 12 – Uphold the Ethical Standards of the Profession and hold each other Accountable

Whilst this standard is supportable, it is not particularly clear what is expected in order to comply with it. The preamble provides no clarification.

Example 31 includes an adviser reporting concerns to both their compliance team and also to ASIC at the same time. It is unclear why the adviser would report this to ASIC before the licensee has had the chance to investigate it. As mentioned in the example, it appears that the adviser is concerned that the original advice may have been inappropriate. Clearly this requires further investigation and the licensee's compliance team are the most appropriate people to undertake this. It is also unclear why the adviser might think that they have the ability to determine if something represents a significant breach, and should be reported to ASIC. The terms of professional indemnity insurance prevent an adviser from immediately admitting to a mistake, and therefore it is unlikely that the adviser could acknowledge the loss to the client and state a view that it may be recoverable against the licensee. It would seem more appropriate to let the compliance team undertake the investigation. If, after further investigation, a clear breach is demonstrated, and the licensee refuses to notify ASIC and refuses to compensate the client, then the adviser may have grounds to report it to ASIC as a whistle-blower. It is appropriate to follow due process with matters like this.

Example 32 illustrates some behaviour that is not conventional. An adviser would not pass file notes to a new adviser, unless they had sold their client book to them. They may choose to provide copies of other documents, such as the fact find and advice documents to the client, however file notes are rarely provided to either a client or a new adviser. It is also unclear whether this might be something that is done in terms of a hardcopy of the documents or a softcopy, which would have greater implications if it was stored in a financial planning software application.

There is a cost involved with all that has been suggested, including a handover teleconference and in the absence of Donna agreeing to pay for it, there is a genuine question mark as to whether this would happen. We have some real concerns about whether this example is trying to set up the expectation that this type of exchange of information will become the expected standard.

Conclusion

In summary, the Code of Ethics guidance has provided little insight into the requirements of the Code of Ethics or direction for financial advisers. The guidance document has instead opened up additional areas of confusion. Many of the examples are either of limited benefit, as they are obviously non-compliant, or they fail to address the core issues where guidance is required.

Having set out in detail the deficiencies and given that it is now early November, with less than two months to go until the scheduled commencement of the requirement to comply with the Code of Ethics, we have reached the following conclusion:

- The Code of Ethics is unworkable in its current form.
- The commencement of the Code needs to be deferred until the Code can be re-worked, and the financial adviser community can sensibly prepare for implementation.

It is unfortunate that the FASEA Board have sought to use this as an opportunity to re-write the law that applies to financial advice, rather than use this as an opportunity to provide sensible guidance to the financial advice community with the development of a Code that is both practical and consistent with the best interests of clients. The financial advice profession has no choice other than to oppose the Code of Ethics in its current form, and ask the Government to deliver a delay in the commencement, whilst these critical issues are resolved.

12 November 2019