FG002

Financial Planners and Advisers Code of Ethics 2019 Guidance

Contents

Part 1: Using this guide

The Financial Adviser Standards and Ethics Authority Ltd (FASEA) produced this guide. FASEA was established in April 2017 to set the education, training and ethical standards of licensed financial advisers in Australia.

In June 2017, FASEA was declared as the standards body under the *Corporations Act 2001*. Under section 921U of this Act, FASEA is responsible for making a Code of Ethics for the purposes of section 921E.

On 8 February 2019, FASEA made a Code of Ethics by Legislative Instrument (the "Code"). [1]

The Code brings together expectations of the Australian community for the provision of professional financial advice. It comprises five (5) values and twelve (12) standards. Compliance with the Code will come into effect on 1 January 2020.

This guide is intended to assist understanding of the Code. The Code is a living document subject to change. It is principle based and is intended to apply to a wide range of situations. This guide is therefore illustrative rather than conclusive regarding application of the Code.

Relevant terms are explained in the glossary to this guide. [2]

Who is this guide for?

This guide is primarily directed to advisers ("you"). It will help you to understand your ethical obligations as established in the Code of Ethics if you are:

- A relevant provider

  That is, if you are an individual who is:

  - a financial services licensee;
  - an authorised representative, an employee or a director of a financial services licensee; or
  - an employee or director of a related body corporate of a financial services licensee;

  and you are authorised to provide personal advice to retail clients, as the licensee or on behalf of the licensee, in relation to relevant financial products.

- A provisional relevant provider

  That is, you are a relevant provider who is undertaking work and training in your professional year.

- A supervisor of a provisional relevant provider

[1] https://www.legislation.gov.au/Details/F2019L00117

[2] The *Corporations Act 2001*, defines a number of words and expressions used in or that are relevant to this guide such as ASIC, financial product advice, financial services, financial services licensee, provisional relevant provider, relevant financial products, relevant provider, retail client and supervisor.

That is, if you are an individual and you:

- have supervisory responsibility for a provisional relevant provider;
- are a relevant provider;
- are not a provisional relevant provider; and
- you are not a limited service time sharing adviser.

This guide will also serve as a point of reference for:

- financial services licensees, and any relevant provider authorised to provide personal advice to retail clients, on behalf of the licensee, in relation to relevant financial products;
- regulators including the Australian Securities and Investments Commission (ASIC); and
- consumers seeking to understand the ethical obligations of advisers.

Context

In 2017 the Commonwealth Parliament amended the *Corporations Act 2001*, to raise the education, training and ethical standards of financial advisers and financial planners.

Between March and June 2018 FASEA conducted consultation on the development of the Code.

The Code seeks to impose ethical duties that go above the requirements of the law and it is designed to encourage and embed higher standards of behaviour and professionalism in the financial advice industry.

Collectively, financial planners and advisers are members of an evolving profession. As such, while you may have formerly provided a commercial service, you should be committed to offering a professional service – informed by a Code that is intended to shape every aspect of your professional conduct.

The changes to education, training and ethical standards are intended to bring a new focus to the requirement that the professional practice of financial planning and financial advice is centred on the best interests of the client. By applying the Code and acting ethically in the service of each of your clients, you will contribute to building public trust and confidence in your profession.

Application

The Code is a compulsory code of ethics for all relevant providers who provide financial services to retail clients. The Code also applies to provisional relevant providers, once authorised and registered by their licensee on the Register of Relevant Providers under section 922Q of the Act.[3] As is the case with all other professions, ultimate responsibility for applying the tenets of the Code falls on individual advisers. Each must be ready to give an account of how they have interpreted and applied the Code in specific situations.

This guide uses case study examples to help illustrate requirements in the Code.

They are not intended to provide definitive guidance. As noted previously, individual circumstances will differ in practice and, as with every profession, there is allowance for differences of professional opinion on how the ethical rules of the profession should apply in a particular case. Doing what is right will depend on the particular circumstances and requires you to exercise your professional judgement in the best interests of each of your clients.

---

[3] Section 921E of the *Corporations Act 2001*, provides: 'A relevant provider must comply with the Code of Ethics.' Section 910A defines provisional relevant provider to mean a relevant provider who is undertaking work and training in accordance with subsection 921B(4) i.e. the 'professional year'. Note however, a person does not become a relevant provider until they are authorised to provide personal advice to retail clients, as the licensee or on behalf of the licensee, in relation to relevant financial products.

You should not consider each of the standards in the Code in isolation. They are intended to operate in combination to strengthen and inspire good practice. You should be aware that the same conduct may breach multiple standards of the Code.

You may demonstrate engagement with the Code by discussing the various case studies and your own experience with your professional peers and being willing to be challenged on your judgement. Discussion of the standards within the profession and with the public is encouraged and assists to demonstrate a willingness to meet the public's expectations for the profession.

Conflicts of interest and duty

As a professional you owe your clients duties that cannot be subverted by your personal interests and that take precedence over duties you owe to other clients, or to third parties. The only exception to this principle is when one (or more) of the duties owed to a client is overridden by an express obligation arising under statute or the general law. 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. Your duty so to act may only be modified or set aside if you are compelled to do so by Law.

The financial services industry is beset with challenges of conflicts of interest and duty that you must address as a competent professional. The Code relates to actual conflicts of interest. You should also be alert to the challenges posed to your professional integrity by potential and perceived conflicts of interest and duty.

Personal responsibility, compliance and enforcement

You have the primary obligation to regulate your own behaviour to comply with the Code. You have a fundamental, personal, professional obligation to understand and to adhere to your ethical obligations under the Code. You cannot outsource this responsibility to your employer, or your licensee, or any other person.

You will need to keep appropriate records to demonstrate, if called upon, your compliance with your obligations under the Code.

Your compliance contributes to building public trust in your profession.

Your financial services licensee also has a role under the Act in monitoring and enforcing your compliance with the Code.

Your licensee has a role to play in seeking to structure their business operations in a manner that facilitates you being able to operate ethically under the Code.

Part 2: Practical guidance

The five values

The Code requires financial advisers to act in a way that demonstrates, realises and promotes the following five values:

(a) Trustworthiness;

(b) Competence;

(c) Honesty;

(d) Fairness; and

(e) Diligence.

The Code stipulates that these values are paramount and that all provisions of the Code (which includes the Standards) must be read and applied in a way that promotes the values.

Trustworthiness

Acting to demonstrate, realise and promote the value of trustworthiness requires that you act in good faith in your relationships with other people. Trust is earned by good conduct. It is easily broken by unethical conduct.

You earn trust by being reliable in your relationships with others, and by doing what you say you'll do. Trust requires having the courage to do what is right, even though you may suffer personal detriment by doing so. It requires that you are loyal to each of your clients, and that you keep client personal information entrusted to you private and confidential. It requires that you should not subordinate your duty to your client, or your client's lawful interests, to your own interests and any obligation you may owe to a third party, including an employer or a financial services licensee.

Trust requires you to act with integrity and honesty in all your professional dealings, and these values are interrelated.

Acting ethically, with trustworthiness, promotes trust by consumers in the profession of financial advisers, promoting community confidence in accessing and utilising professional financial services.

Competence

Acting to demonstrate, realise and promote the value of competence requires you to have regard to the knowledge, skills and experience necessary to perform your professional obligations to each of your clients. It requires you to assess the professional services required by each client with regard to their individual needs, priorities, circumstances and preferences, expressed or implicitly identified as the subject matter of the financial advisory engagement. Whilst it may be possible to supplement your professional competence by accessing the expertise of others, the duty of competence is ultimately personal and cannot be outsourced to others. If you don't possess the particular competencies required to assist your client, in accordance with other ethical requirements in the Code, you must refer your client to another professional.

The value of competence requires your life-long commitment to developing and maintaining knowledge, skills and expertise at a level of currency required to benefit your clients in particular engagements, and in anticipation of other client engagements in the course of your professional career.

It requires your regular self-reflection and the exercise of professional judgement to determine when to augment your knowledge, skills and experience with assistance from other professional financial advisers, or indeed other professionals with specialist expertise in the service of the client's best interests.

Honesty

Acting to demonstrate, realise and promote the value of honesty requires that you conduct yourself with integrity in all your professional dealings with your clients and with all others that you engage with in the professional setting. It requires transparency, frankness and fairness to each of your clients even where this may cause your personal detriment. Being honest means more than just technically telling the truth, it may require you not to withhold information from your client that your client would want to know.

Fairness

Acting to demonstrate, realise and promote the value of fairness requires that you bring professional objectivity to the task of engaging clients professionally, and when recommending financial products and professional services. It requires you to properly investigate, evaluate and diagnose a client's need for professional services, to self-reflect on the limits of your professional competency and on your capacity to deliver or access the necessary professional services required in the engagement in a manner that benefits your client.

It requires your objective assessment of your own services (or your firm's) and whether you can bring value to your client. It requires understanding your personal biases, and it may require you to act to mitigate the threat of your own, or your client's unconscious biases to your client's decision making. Being fair requires that you look beyond your own interests and consider how others may judge or perceive your actions. Would your conduct stand public scrutiny by your professional peers and by the community?

Diligence

Acting to demonstrate, realise and promote the value of diligence requires that you perform all professional engagements with due care and skill. It requires you to manage your time and resources to deliver professional services in a timely, efficient and cost-effective way to each client.

It is about the way you go about your professional work, the commitment you bring, and the values you espouse and demonstrate in all your professional interactions with your clients and with others.

It requires that you exercise due care and skill in the way you:

- engage each client;
- understand each client;
- diagnose each client's needs and issues;
- scope or limit the professional services you will provide each client;
- develop strategy solutions and recommendations for each client;
- develop product and service solutions and recommendations for each client;
- ensure the strategy and product solutions you provide to each client are fit for purpose and are intended to improve your client's financial well-being;
- make required disclosures to each client in your Financial Services Guide, Statement of Advice and Record of Advice and in providing Product Disclosure Statements and Investment Memoranda;
- implement agreed recommendations;
- engage each client to deliver on-going services (including reviews) if appropriate;
- undertake record-keeping in respect of the professional services you provide each client; and
- meet your obligations in the law in respect of the advice you provide to each client including:
    - best interests' duty;
    - appropriateness of advice;
    - prioritisation of client's interests;
    - additional requirements for product replacement recommendations; and
    - Australian Taxation laws.

It requires that you keep abreast of developments and options for clients.

Standards

There are twelve standards.

Standard 1

You must act in accordance with all applicable laws, including this Code, and not try to avoid or circumvent their intent.

The Explanatory Statement[4] indicates this Standard requires, as an ethical duty, that you comply with your legal obligations and not seek to avoid them. This is a minimum ethical obligation.

Example 1: Inbound referral

Nichole has a variable income as a Nurse Practitioner and earns about $140,000 on average per annum depending on contract work she can get and shifts. Nichole's husband Aaron earns $120,000 per annum as a Manager with an equipment hire firm. Their 3 children from Nichole's first marriage have all left home. Nichole and Aaron own their own home and a coastal investment property that they hope to retire to one day. They have some equity in both properties and their bank has indicated they will be able to get approval for a further investment loan. They live frugally and are putting all their resources into paying down their mortgages to build a nest egg for their retirement in about 10 years' time. They both have some superannuation savings.

Nichole and Aaron are introduced to Nathan, a financial adviser, by a local property developer who has suggested to them they would be better off to establish a Self-Managed Superannuation Fund (SMSF) to invest in a property.

The referring developer has told Nichole and Aaron that he has a referral arrangement with Nathan which has the effect that, should they decide to go ahead and purchase an investment property in his new development, he will pay Nathan's Statement of Advice (SOA) Fee for them.

Nathan has an interest in an SMSF administration business.

Nathan offers to establish the SMSF on an 'execution only' basis without providing any financial product advice to Nichole and Aaron on the appropriateness of an SMSF for them. He then provides financial product advice to rollover the client's existing superannuation to the SMSF.

Nathan benefits from receiving on-going referrals from the property developer and receives an on-going benefit by Nichole and Aaron becoming new SMSF administration clients.

Guidance

Nathan breaches:

Standard 1 – A retail client referred to an adviser in these circumstances is likely to believe they were getting personal advice. It is likely Nichole and Aaron would expect Nathan, as their financial adviser, to critically assess whether it would be appropriate in their circumstances to establish an SMSF to purchase an investment property. In offering to establish the SMSF on an 'execution only' basis it is likely Nathan intended to circumvent the intent of financial services laws that mandate certain disclosures and provide certain protections to consumers receiving personal financial advice as retail clients, including requirements that Nathan acts in the best interests of his clients Nichole and Aaron in relation to his advice.

[4] Explanatory Statement to the Financial Planners and Advisers Code of Ethics 2019 (ES) at paragraph 25.

Other considerations

Nathan also breaches **Standard 2**. He has failed to act with integrity and in the best interests of Nichole and Aaron.

Standard 3 is also breached – the prospect of a direct payment of Nathan's fees by a third-party (the developer) is a benefit under the code [see guidance on Standard 3 later in this document]. Its receipt would create a conflict between Nathan's best interest duty to Nichole and Aaron and the interests of the developer.

This is unfair to Nichole and Aaron who are entitled to rely on Nathan's objectivity. Similarly, the prospect of future referrals from the developer may elicit conscious or subconscious bias contrary to the clients' best interests. To comply with Standard 3, Nathan must avoid the conflict between his duty to act in Nichole's and Aaron's best interests and his interest in receiving further referrals. He should cease the relationship with the developer to avoid the conflict of duty and interest, even though he will lose out on referrals.

Nathan also stands to benefit through his associated SMSF administration business from executing the SMSF strategy for Nichole and Aaron. Nathan has not investigated nor clearly demonstrated to Nichole and Aaron, that the establishment of the SMSF and associated investment strategy is in their best interest, or, that his advice complies with the other provisions of the Code. It is reasonable to assume the benefit may influence his decision to execute the SMSF strategy for Nichole and Aaron. As it impedes his ability to act or advise Nichole and Aaron with professional objectivity and in accordance with his duty to act in his clients' best interests, Standard 3 requires that he refer out the SMSF component of the advice.

Example 2: Wholesale investor

Donna and her husband Dale jointly own their family home in Bondi currently valued at $3.4 million. Wallace is their stockbroker and financial adviser. Wallace is authorised to provide personal advice to retail clients; however, Wallace has accountant's certificates indicating Donna and Dale are wholesale clients for the purposes of s.761G(7)(c) of the Corporations Act based on the value of their assets.

Donna approaches Wallace because she came into an inheritance of $20,000 from a cousin and wanted investment advice without involving her husband. It is clear to Wallace that Donna has no experience with money matters and has never before made an investment. She told Wallace that she always relied on her husband to worry about such matters but that she didn't want him to know about the inheritance.

Wallace makes a recommendation to Donna to buy $20,000 VubberLife shares. Unfortunately, VubberLife comes under scrutiny from a public inquiry. During the course of the public hearings its shares fall about 25%. 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.

Donna complains to Wallace's financial services licensee about the failure to receive adequate advice and seeks compensation.

His firm collects and analyses data on Wallace's client profiles. The analysis shows that Wallace holds an accountant certificate for more than 70% of his clients indicating they hold either income of $250,000 gross per annum for each of the last 2 financial years, or $2.5million in net assets. Like Donna and Dale, many of Wallace's clients who are certified as 'wholesale' on the basis of the wholesale client assets test are couples in their 70s with limited competence in financial matters.

Guidance

Wallace breaches **Standard 1** – by treating Donna as a wholesale investor and relying on the accounting certificate he ignores her lack of competence in financial matters.

Whilst technically the assets test permits Wallace to attribute the same jointly held assets to both the husband and the wife, Wallace has failed to act ethically.

As he is a person authorised to provide personal advice to retail clients, he is bound by the Code. He has tried to circumvent the intent of the laws designed to protect investors like Donna who may lack competency in financial matters.

Other considerations

Wallace's conduct also breaches **Standard 2**. By treating Donna as a wholesale client, he benefits by not having to comply with retail client disclosure laws and the best interest duty and related obligations.

Example 3: Product upgrade

Julia is a 48 years old mother of two teenage children. She was widowed in 2010 when her partner lost his battle with cancer. Fortunately, she received a significant death benefit at the time from her husband's super and under her adviser Carroll's advice, she paid off the mortgage on the family home and invested the balance for the family's future in a financial product offered by XYZ. Carroll knows that, whilst Julia and her children are well set up, she still struggles month-to-month meeting the household living expenses.

Upon review of Julia's portfolio Carroll identifies that the existing product provider (XYZ) has a new product which is equivalent in terms of benefits and features to the product in which she is already invested but has a different and cheaper fee structure so that the returns over time on the new investment product are likely to be higher than the returns on the old product (and there are no, or minimal, adverse tax consequences of upgrading to the new product).

The new post - Future of Financial Advice (FOFA) reform product will not pay a trailing commission to the adviser.

Carroll recommends Julia replace the existing product with the new cheaper product.

Guidance

Carroll complies with **Standard 1**

It may be lawful for Carroll to receive a 'grandfathered' financial product commission from the old product. However, Carroll recognises the intent of the preservation of existing contracts by the CORPORATIONS AMENDMENT (FUTURE OF FINANCIAL ADVICE) BILL 2011 is that advice transitions over time to a fee for service arrangement in the public interest. By recommending the product upgrade and forfeiting the grandfathered commission, Carroll is acting in accordance with the intent of the law.

Other considerations

Carroll's conduct complies with **Standard 2**

Acting with Integrity and in the best interests of the client includes being truthful and fully frank with the client about information you become aware of which it is in their interests to know and act on. Carroll would not be treating Julia fairly if she failed to bring the new product to Julia's attention.

Further, Carroll has been engaged by Julia to undertake a review. Acting in Julia's best interest requires, subject to express limitations in the terms of Carroll's engagement with Julia, for Carroll's review of the product, 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 for Julia's circumstances, needs and priorities at the time of the review. Acting fairly to Julia may even require that Carroll consider products outside her licensee's approved list.

By contrast, Carroll would breach **Standard 2** (and may breach financial services laws) if she avoids recommending the new product, because she is receiving a financial product commission from the old product. Such conduct would lack integrity and she would breach **Standard 3.**

Standard 3 - Carroll's interest in continuing to receive the product commission on the old product conflicts with her duty to advise her client in her client's best interests. Under **Standard 3** she must avoid such a conflict between interest and duty.

Carroll takes appropriate steps to avoid the conflict of interest and duty by duly reviewing the suitability of the product for Julia's needs and circumstances and recommending in Julia's best interest that she replace the old product, terminating the commission.

Standard 2

You must act with integrity and in the best interests of each of your clients.

The Explanatory Statement indicates this Standard requires, as an ethical duty, that you act with integrity. It also requires you to act in the best interests of each client.[5]

Acting with integrity requires openness, honesty and frankness in all dealings with clients. These qualities underpin the trust that clients should have in you as a professional. It also requires you to keep your promises (explicit and implied) and honour the commitments you or your principal make to your clients.[6]

Each of the duties to act with integrity and in each client's best interests is fundamental.[7]

You act in a client's best interests if what you do—the advice you give, the products and services you recommend—are appropriate to meet the client's objectives, financial situation and needs, taking into account the client's broader, long-term interests and likely future circumstances. The test is, in short: will your advice and recommendations improve the client's financial well-being?[8]

Section 961B of the Act imposes an obligation on persons who provide personal advice to a retail client to act in the best interests of the client in connection with the advice. That section, together with sections 961C, 961D and 961E, have the effect that the person satisfies the section 961B duty if the person:

- identifies the retail client's objectives, financial situation and needs, as disclosed to the person;
- identifies and completes any reasonably apparent gaps in the information;
- conducts a reasonable investigation of potential financial products; and
- bases his or her judgements on the client's relevant circumstances.[9]

The ethical duty in Standard 2 to act with integrity is a broad ethical obligation. It is based on a more professional relationship between the relevant provider and the client, where the relevant provider has a duty to look more widely at what the client's interests are.[10]

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.[11]

---

[5] ES:26
[6] ES:27
[7] ES:28
[8] ES:29
[9] ES:30
[10] ES:31
[11] ES:32

You are not relieved of the ethical duty merely because the client does not provide enough information, even when asked.[12]

The ethical duty in Standard 2 to act in the client's best interests is not identical to the duty in section 961B of the Act. Sections 961B(2) to (4) describe a series of steps that a relevant provider may take; if those steps are taken, the relevant provider will have satisfied the "good faith" duty in section 961B(1). This Code does not have any equivalent provisions.

So, even if you follow the steps set out in section 961B of the Act, you may still not have complied with the duty under the Code to act in the client's best interests.[13]

Other aspects of the duty in the Code to act in the client's best interest include:

- you must keep confidential all information about the client that you are given or obtain in connection with you or your principal acting for the client. You must not use or disclose this information for any purpose other than advising the client unless the client has specifically agreed, or the law requires you to;
- you must treat all clients in a respectful and professional way; and
- you must treat all clients fairly, as between themselves. You should provide professional services to all clients, managing your business so that each client has a fair share of your attention, skills and time.[14]

You should take into account your client's express wishes, but these do not override your duty to give advice that is in the client's best interests.[15]

Example 4: Inappropriate scope of advice

Gavin and Marcella earn high incomes as medical specialists. They have 2 school age children at private schools and have a large mortgage over their dream home in the inner city. They approach a financial planner, Lena, seeking help to manage their money with less stress. Gavin and Marcella explain to Lena that by the end of each monthly pay cycle they're struggling to pay their bills and their credit card debt just won't come down. They have been reading about 'mortgage stress' and worry they might still be paying off their mortgage long after they retire. Marcella also worries if something happened to Gavin, she wouldn't be able to cope on her own with the children.

Lena provides scaled advice covering superannuation and insurance.

Lena recommends that Gavin and Marcella replace their existing superannuation and insurance on the basis the existing insurance option within their industry super fund is age based with decreasing cover.

Lena is aware that Gavin received previous treatment for mental health issues when he was a younger Registrar working in a Public Hospital, and the new cover has a mental health exclusion which Lena omitted to discuss with them. Unfortunately, they act on her recommendation.

Gavin and Marcella receive no advice from Lena to reduce their overall debt and pay off their mortgage faster and she advises them each to make salary sacrifice superannuation contributions in order to partly cover the costs of their new insurances.

---

[12] ES:33
[13] ES:34
[14] ES:35
[15] ES:36

Guidance

Lena breaches:

Standard 2 – Lena's failure to advise Gavin and Marcella on budgeting, cash flow and debt reduction and management, means her advice is not consistent with the couple's purpose in seeking advice.

Lena's failure to explore Gavin's pre-existing mental health condition, prior to recommending the change of cover, places Gavin and Marcella in the position that they are unable to effectively evaluate the trade-off between the existing cover and the recommended cover. Lena has failed to act in the best interests of Gavin and Marcella because Gavin is likely to be better off retaining his existing cover (with mental health cover included), rather than acquiring new cover with the mental health exclusion, despite the expanded terms. Given their large mortgage, the advice appears to worsen, rather than improve, Gavin and Marcella's financial well-being. The advice to salary sacrifice to partly pay the new insurance premium leaves them further out of pocket. The advice may also breach financial services law, including the best interests' duty, as it fails to adequately identify and address the subject matter of the advice being sought by the client and the obligation to provide appropriate advice having regard to the clients' circumstances.

Example 5: Limited scope engagement

Ivan and Ivanka are newly married and expecting their first child. Ivan is a teacher and recently lost a colleague to cancer. His colleague's surviving spouse and young child are struggling financially. His insurances were limited to the death and TPD cover in his state government superannuation fund. The insurance pay-out simply wasn't enough to cover the couple's mortgage and the medical bills. Ivan doesn't want his family to be left in the same situation.

Ivan and Ivanka approach Ann a financial adviser whose business provides advice only on life risk insurance products for which she takes a commission. Ivan tells Ann they don't have a lot of money and he just wants to get insurance, so his family is protected. Ivanka doesn't have access to paid maternity leave and she will have to leave work in a month or two to have the baby. They own their apartment but don't have much equity. They've heard that the life insurer can just pay some advisers commission so they wouldn't be out of pocket for the adviser's fees. They have some default superannuation, a car loan and some credit card debt incurred establishing their home and preparing for the baby.

After conducting a limited fact-find, Ivan and Ivanka engage Ann on a limited scope basis to arrange $300,000 of additional stand-alone life cover for Ivan via the life insurance company associated with Ann's licensee. Ann excludes advice on superannuation and also on credit, as she doesn't hold a credit licence. She also excludes trauma cover - given the couple's limited means, she doesn't think they could afford it.

Ann prepares and presents a fully compliant statement of advice recommending the additional cover. Ivan and Ivanka wonder whether they can afford the additional premium.

Ann is not authorised to advise on super and in any case, Ivan's teacher's fund is not on her licensee approved product list. Under her limited scope engagement, she did not investigate Ivan's existing cover held through his super fund. Unbeknown to Ann and Ivan, Ivan's super fund permits the purchase of top-ups of units of his existing life cover at key lifetime milestones including the birth of a child. With a modest adjustment to their spending, the additional $200,000 in cover would be significantly easier for the couple to afford than the premium on $300,000 of stand-alone life cover.

Guidance

By scoping out and failing to consider Ivan's existing insurance cover inside super, Ann fails to act in Ivan's best interest in breach of **Standard 2**.

A limited scope engagement can be a highly effective tool to provide clients who have limited means or resources to access comprehensive advice.

However, whether the use of a limited scope engagement is consistent with **Standard 2** and other Standards in the Code will depend on the individual client's circumstances, including their need for particular advice.

The adviser needs to undertake a sufficient initial investigation of the client's circumstances in order to establish the client's need for advice overall.

Where the client has need for advice concerning multiple issues, the adviser should work with the client to address how those issues may reasonably be prioritised and addressed, including over a longer time frame or by other service providers. If the client's advice needs can be met by a limited scope engagement, the adviser should obtain comprehensive information about the client's circumstances as it relates to the particular advice.

If that is not done, there is a risk that relevant issues and priorities for advice will not be satisfactorily addressed.

There is a strong onus on the adviser to act fairly and exercise professional judgement about whether a limited scope engagement is appropriate and, in the client's, best interest as the client may not fully understand the consequences of deferring or scoping out advice on some issues.

The integrity risk to the adviser may be heightened where the business model under which the adviser operates conflicts with the client's need for advice on a particular issue. In the example, Ann breaches the integrity requirement in Standard 2. She should have investigated Ivan's insurance entitlements within his super and if her preferred business model prevents her doing this, she should have declined the engagement and considered referring the couple to another adviser or to the adviser tied to Ivan's super fund. She has not been fair in her dealings with Ivan and Ivanka.

Other considerations

Ann has a business model conflict that limits her capacity to advise in these circumstances and conflicts with Ann's duty to her client: she receives financial product commissions for the insurance products she recommends, and the amount is dependent on the amount of the issuer's product she recommends. She is currently permitted by law to operate this conflicted business model, but she must still comply with other financial services laws that require her to act in the best interests of her client, provide advice that is appropriate to her client, and to prefer her client's interests in the event of the conflict or avoid the conflict. To comply with **Standard 3** and the law, she ought to have avoided the conflict and declined to advise Ivan and Ivanka or referred them on to another professional who is able to address their needs.

Standard 3

You must not advise, refer or act in any other manner where you have a conflict of interest or duty.

In General

The Explanatory Statement indicates the primary ethical duty in this Standard is that, if you have a conflict of interest or duty, you must disclose the conflict to the client, and you must not act. If the client wishes, you may refer the client to another relevant provider if neither you nor your principal will receive any benefits from the referral.[16]

The Code of Ethics must be read and applied as a whole. Therefore, Standard 3 operates in combination with the values and other standards prescribed in the Code of Ethics in order to strengthen and inspire good practice.

The Code and therefore Standard 3 applies to relevant providers and imposes duties and obligations on relevant providers only.

The standard refers to actual conflicts of interest between the duties you owe your client and any personal interest or duty you owe another individual or organisation.

Remuneration and profit sharing

You will not breach Standard 3 merely by being a duly remunerated employee of an entity that lawfully provides retail financial advice and services, provided that the provision of that advice and services are in the best interests of your client and comply with the other provisions of the Code.

You will not breach Standard 3 merely by receiving a share of profit from an enterprise that lawfully provides retail financial advice:

- in which you are an owner/principal, and
- which provides the sole context within which you practise your profession as an adviser, and
- in which you act in the best interests of your client, and
- in which you comply with the other provisions of the Code.

Income derived from ancillary products and services

You will not breach Standard 3 if you share in profits generated by the provision of ancillary products and services to clients providing that:

- the ancillary products and services are merely incidental to the adviser's dominant purpose in providing advice, and
- the ancillary products and services recommended are in the best interests of your client – conferring on the client value that is equal to or greater than that offered by any other option.

You will breach standard 3 where the dominant purpose of providing advice to clients is to derive profits from selling those clients ancillary products or services from which you personally benefit.

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.

[16] ES:37

You will also breach Standard 3 in the case where you provide financial advice to invest in a retail product or service from which you benefit and where a reasonable assessment of the circumstances of the client would conclude that the best course of action would be that there should be no change to the client's circumstances or plan.

Cases:

- Harry recommends that his client Fred acquire a particular financial product. Harry's remuneration includes a bonus depending on the volume or value of that financial product that is sold. Harry's potential entitlement to the bonus creates a conflict of interest or duty, as it would reasonably appear to influence his advice to Fred.

- Sally has 2 long-term clients, Bill and Emily, a married couple. They tell Sally that they are divorcing. Because of the divorce, their interests will no longer be the same. If she were to continue to act for both of them, Sally's duty to Bill would conflict with her duty to Emily.

- George is a partner in a multi-partner advisory practice, where the partners have expertise in different areas. George does not have expertise in self-managed superannuation funds but Elaine, another partner, does. Newman is a new client of George's. George realises that Newman needs advice in relation to a self-managed superannuation fund. George refers Newman to Elaine, who competently advises him. Although both George and Elaine will benefit (through the partnership) from keeping Newman as a client, George does not have a conflict of interest and the benefits both George and Elaine get do not flow from the referral but from providing the advice to Newman. In fact, George has acted in Newman's best interest by enabling him to get competent advice.

Disclosing to the client any advantages you would receive, and obtaining your client's consent (see, for example, Standard 7), will **not** relieve you of the duty to comply with this Standard.[17]

Example 6: Brokerage, advice and remuneration

Under the remuneration structure of her stockbroking firm, Yasmin is able to retain a further 10% of total brokerage earned by her firm on trades if she generates more than $80,000 in brokerage in any month. Her firm takes advantage of the carve out from the conflicted remuneration provisions introduced by the Future of Financial Advice reforms. Coming up to the last day of the month, Yasmin receives a report from her manager which shows how she is tracking towards her monthly brokerage target. She notices that she is only short of the required $80,000 in brokerage by about $2,000.

In order to ensure she makes her brokerage target, Yasmin calls several clients earlier than in her regular review schedule and, with no actual research or review of the client portfolio, recommends rebalancing each of their portfolios "because you are heavy in the banks". Yasmin creates a Record of Advice and places the orders. It turns out that over the following week that the bank shares fell, and the clients avoided a minor loss.

Guidance

Although the clients avoided a loss in the short term, Yasmin's behaviour breached **Standard 3**, as the actual reason for advising the clients was to earn an increased proportion of total brokerage by 'churning' client accounts. Yasmin derives a benefit from her rebalancing advice in conflict with her duty to act in her clients' best interests.

[17] ES:39

Example 7: Conflicted associated party benefits

Regina the finance lawyer

Regina, a finance lawyer in her late 50's is seeking retail financial product advice on pre-retirement strategies from her financial planner Cedric.

In addition to being a director and principal of a small financial advice licensee, Cedric is a principal of an associated accounting business. Cedric does not receive any fee or benefit linked to clients he refers to the accounting firm. His remuneration is strictly limited to his share of the profits made by the associated firm, in the course of normal business.

Cedric advises Regina to establish an SMSF and rollover her existing $1,200,000 superannuation into the SMSF to invest in a range of assets including diversifying Regina's superannuation investment portfolio to include a broader range of asset classes than are available in her existing fund.

Cedric's advice to Regina considers and compares the advantages and disadvantages of other viable strategies, including maintaining her current superannuation fund and strategy, considers Regina's long term cashflow needs from the SMSF and demonstrates clearly and simply that the strategy of broadening the asset classes is in her best interests. Cedric's advice clearly explains the risks involved in the strategy and how these will be managed. He establishes that Regina has the financial understanding and time to operate the SMSF and understands the risks and costs associated with the implementing the advice.

In offering to provide ongoing accounting services to Regina to manage the SMSF, Cedric presents Regina with a schedule of fees and charges that confirms that the fees are on a for service basis rather than based on the amount or volume of funds invested in the SMSF. Cedric is able to demonstrate the proposed fees and charges are fair and reasonable and represent value for money for Regina by comparing them to the market for those accounting services. He demonstrates that the fees and charges are proportionate to the balance of the superannuation fund.

Cedric explains to Regina the services that will be provided and how those services will be reported to her. Cedric establishes Regina understands the services to be provided and the costs and risks involved and that she consents.

Guidance

The advice to Regina

The advice to Regina **complies with Standard 5** because by investigating Regina's current superannuation fund, her future cashflow needs and comparing the advantages and disadvantages with other viable strategies, Cedric has a basis to establish the advice is in Regina's best interests and appropriate to her individual circumstances.

Referral of Regina to accounting business

Like many small multi-disciplinary businesses, Cedric operates the accounting business under a separate legal entity from his financial planning firm in order to satisfy professional indemnity insurance requirements to quarantine the risks in each business.

There is a potential for Cedric to breach **Standard 3**. A conflict of interest will arise if Cedric refers Regina to his accounting business to establish the SMSF and to provide ongoing accounting services, as Cedric will derive a financial benefit as an owner of the accounting business unless Cedric can clearly establish that the advice is in Regina's best interests and in compliance with all provisions of the Code, including establishing the fees and charges are fair and reasonable and represent value for money for Regina.

Cedric confirms:

1. it is in Regina's interests that she receives professional accounting services in support of the recommended SMSF; and
2. Cedric's sole benefit in referring Regina to his accounting firm is his share of any profits made by the accounting firm in general – and not in relation to his referral; and
3. the fees charged by the accounting business are not based on the amount or volume of funds invested through the SMSF and are proportionate to the balance of the superfund; and
4. he has taken steps to establish the fees and charges are fair and reasonable and represent value for money for Regina – by comparing them to the market for those accounting services; and
5. the accounting firm has the requisite expertise and competence to provide the services; and
6. that establishing the SMSF is in Regina's best interests and that Regina has the financial understanding and time to operate the SMSF; and
7. Cedric has obtained Regina's free, prior and informed consent to all the benefits she will receive from the accounting firm in connection with the recommendation to Regina to establish the SMSF and rollover her superannuation.

Cedric does not breach **Standard 3** in making the accounting referral only because the advice is demonstrably in Regina's best interests.

Example 8: Non-conflicted referral arrangement

Bev, an accountant, is aware a number of her clients have engaged the same financial planner and been highly impressed with the results. She approaches the planner, Kate, to establish a mutual referral arrangement.

Similarly, Kate has heard good reports from her clients who have dealt with Bev and she is open to establishing the arrangement. However, she is mindful of her obligations under the Code and explains to Bev that she cannot enter into the arrangement if it gives rise to a conflict of duty or interest. 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. She highlights any payment share of fees, or an expectation of future referrals would constitute a conflicted benefit. She is not able to enter into an exclusive arrangement, nor is it her practice to make a personal recommendation.

However, she is able to agree, where she believes a referral to an accountant will be of benefit to her client, to refer without making a personal recommendation. She will tell her clients who inquire about a referral or who she thinks need one, that other clients report that they are very happy with Bev's work. She advises Bev she will also nominate other accountants with whom she has a similar non-exclusive arrangement. Bev, who is bound by similar ethical requirements under Accounting Professional Ethics and Standards Board (APES) standards, agrees. They also agree to review their arrangement every six months to ensure it is working effectively for the benefit of their mutual clients.

Guidance

Kate complies with **Standard 3**.

In the event of a conflict of interest or duty Kate cannot advise, refer or act. Referral arrangements that confer a benefit (whether financial or otherwise) on the referring party, create a conflict of interest and duty for the recipient of the benefit and must be avoided.

Other considerations

Kate also complies with **Standard 2.**

A referral from a trusted adviser to another professional carries some risk that your client will suspend their own judgement and accept the other professional's advice simply because they trust you to refer them appropriately. Unless you are going to specifically endorse the other professional's advice, it is better that the referral be at arm's length and without the influence of any payment or benefit or expectation of future reciprocal referrals.

Example 9: Selling IPOs

Scott works for a securities dealer which specialises in advising in small cap stocks. Scott is aware of two upcoming biotech IPOs that aren't of interest to him as they are not in his usual space of mining start-ups. Scott hears in the office that both IPOs have a relatively high 6.5% stamping fee. Stamping fees have a carve-out from the conflicted remuneration provisions introduced by the FoFA reforms. Scott's firm allows its advisers to either keep the stamping fee or rebate it to the client. Scott usually rebates the stamping fee. On this occasion as he has school fees to pay, Scott decides that he will keep the stamping fee for clients who haven't previously participated in IPOs and aren't aware of his usual practice.

Scott begins calling clients and explains that there is some risk to the investments, but that they could also provide some diversification. Several clients subscribe to one or both IPOs, one of which increases in value on listing and the other immediately losing value.

Shortly after the listing, one client who lost a significant sum in one of the IPOs calls wishing to make a complaint about Scott's advice to invest in the IPO as he felt pressured into it. Scott holds no biotech shares bought in the IPOs and tells his client that he didn't see the loss coming himself.

Guidance

Keeping the stamping fee rather than applying his usual practice of rebating it was unfair to Scott's clients. The option to keep the stamping fee creates a conflict between Scott's interest in receiving the fee and his client's interests. **Standard 3** requires Scott to avoid the conflict of interest. It is not sufficient for him to decline the benefit as it may be retained by his principal. Either the firm must decline the stamping fee altogether, or Scott must rebate it in full to his clients.

Other considerations

Because his decision to "sell" the IPOs to clients was motivated by Scott's cashflow needs, Scott fails to act with integrity and in the best interests of his client. He breaches **Standard 2**.

He also conceals his usual practice of rebating the fee to his clients. This is unfair. It is also dishonest. His actions may also breach financial services laws.

Scott's further behaviour in relation to the complaint lacks integrity and breaches **Standard 2**. Escalation of the complaint would have led to an internal review of his selling practices, which he was seeking to avoid.

Example 10: Avoiding a conflict of interest
Tom is a stockbroker and shares in brokerage fees with his firm. When he recommends securities, his firm is advising on, his brokerage is a fixed fee only and not dependent on the amount of the particular stock he transacts. Tom's firm is arranging a book build for a services company. The company indicates it will provide tickets to the Bledisloe Cup Rugby Series home games to the broker in Tom's firm who sells the most stock by a given date. Tom is a keen rugby fan. Tom reviews his client Mary's portfolio and after considering her circumstances, and after duly researching the stock offer, decides it would be in Mary's best interests and appropriate to recommend she participate in the stock offer. Tom discloses the conflicted non-pecuniary benefit and the conflict of interest in advising on the offer arranged through his firm and emails his manager to advise he is unable to participate in rewards of this nature due to the conflict with his duty to act in the best interests of his client. The flat brokerage fee charged represents value to Mary having regard to the market for broking services and the size of her proposed investment in the stock.
Guidance Tom complies with **Standard 3** as his only remuneration is the share of the fixed fee brokerage he receives in association with the transaction on behalf of Mary, he has disclosed his firm's vertical integration conflict on the stock and disclosed and avoided the non-pecuniary incentive, and only acted in Mary's best interests.
Other considerations Tom also complies with **Standard 7** by declining the rugby tickets incentive from the issuer, as this is a third-party benefit and by ensuring the brokerage fee is reasonable for Mary.

Standard 4

You may act for a client only with the client's free, prior and informed consent. If required in the case of an existing client, the consent should be obtained as soon as practicable after this Code commences.

The Explanatory Statement indicates this standard requires that you only act for a client with the client's free, prior and informed consent.[18]

This means that, before you start to act, you must have explained to your client, clearly and simply:

- what services will be provided; and
- the terms on which they will be provided; and
- the records that will be made of the services, and the privacy and confidentiality arrangements applicable to them.[19]

Existing clients' consent must be obtained as soon as practicable after the Code commences. Section 2 of the Code states when it commences.[20]

[18] ES:40
[19] ES:41
[20] ES:42

"Informed" consent requires that the client understands and agrees to the arrangements. You will need to be satisfied of this and have reasonable grounds to be satisfied.[21]

Example 11: Lack of informed consent to general advice Ahmed is referred to Sheila for financial advice on the basis of his existing investment portfolio to consider other financial products that may provide additional benefits. Sheila is authorised to give personal advice to retail clients. Sheila provides general advice on an alternative investment that was more complex and carried a higher risk. Sheila provides a general advice warning and obtains a signed general advice waiver from Ahmed. However, she does not provide any explanation of the difference between general and personal advice and does not offer to provide personal advice to Ahmed. Despite signing the waiver, Ahmed does not understand the limitations of receiving general advice and the potential benefits of personal advice. This impacts his ability to make an informed decision.
Guidance Sheila breaches **Standard 4** – she does not have reasonable grounds to be satisfied Ahmed has understood the limitation on the advice she provided.
Other considerations There is a higher onus on the adviser to explain the risks and potential adverse consequences when advising on more complex and higher risk products. If an adviser deliberately avoids investigation of the client's needs and circumstances in order to characterise the advice as general advice, they are also likely to breach the integrity principle in **Standard 2** and their conduct may constitute misleading and deceptive conduct. In order to act in the client's best interests where an adviser has a client referred for general advice, it is important that the adviser conducts sufficient investigation of the client's circumstances to establish that providing general advice is consistent with the client's wishes, needs for advice and the purpose for which the advice is being sought. Personal advice should be offered if required or requested and consistent with the client's needs for advice and circumstances and purpose in seeking advice.

[21] ES:43

Example 12: Gaining client understanding and informed consent

Wanda is recently widowed. She is 68 years old and her late husband Philippe had managed all the family finances. The manager in her local bank branch has noticed she is rolling over large amounts monthly in term deposits. She agrees to see Deepak, the branch's Senior Financial Planner, for advice regarding her late husband's estate.

Deepak makes recommendations on restructuring assets and an appropriate income stream to meet Wanda's lifestyle needs.

Wanda, who Deepak knows has no experience in financial matters, says she understands the recommendations and is happy to proceed.

However, Deepak isn't sure Wanda really understands. He explains that it is important for Wanda to fully understand the advice and the implications for her before deciding to go ahead. He offers to take Wanda through an education program designed to assist her to understand the financial concepts involved in the recommendations. She accepts. Deepak is able to tailor his presentation of the program to Wanda's level of understanding and by the end, Deepak is confident Wanda understands his recommendations and is able to give her informed consent to proceed.

Guidance

Deepak complies with **Standard 4**. It is not sufficient for him to simply explain the effect of the recommendation to Wanda and gain her written authorisation to proceed. Deepak must also be satisfied that Wanda understands his explanation about the effect of his recommendations before he can implement the recommendations on her behalf.

Deepak takes care to ensure Wanda sufficiently understands the recommendations before providing her consent to proceed.

Where the adviser is not satisfied the client understands the recommendations being made, the adviser must not proceed to implement the recommendation. To do so would breach **Standard 5**.

Other considerations

Deepak also complies with his duty to act in good faith under **Standard 9.**

Example 13: Timeshare

Murray and Cecilia are enjoying a relaxing holiday at a beachside resort. They mention to the concierge in passing that they wish they could stay there every year. The concierge tells them to speak to Bob, who might be able to help them do that. Bob is a sales representative / financial adviser. He asks the couple about their personal circumstances and then recommends they purchase an interest in a timeshare scheme. Murray and Cecilia tell Bob that they are interested in the scheme and think they might like to purchase the interest, but they are worried that the contract is for 30 years and they would like more time to learn about the scheme and to talk it over together when they return home from the holiday. Bob strongly encourages them to purchase the interest straight away, saying "it's no big deal because you can always change your mind in the cooling-off period".

Bob's conduct breaches **Standard 4** as he has not ensured that the couple's consent to purchase the timeshare interest is free, prior and informed, as he has encouraged them to defer detailed consideration of the scheme during the cooling-off period (rather than satisfying themselves of the merits of the scheme before purchase, and then using the cooling-off period to reflect on that decision).

Other considerations

Bob's emphasis on the cooling-off period is not made in good faith, because a cooling off period is not a replacement for fully considering the scheme before purchase. This is unfair to Murray and Cecilia and Bob has not met **Standard 9**.

Standard 5

All advice and financial product recommendations that you give to a client must be in the best interests of the client and appropriate to the client's individual circumstances.

You must be satisfied that the client understands your advice, and the benefits, costs and risks of the financial products that you recommend, and you must have reasonable grounds to be satisfied.

The Explanatory Statement indicates this standard elaborates on the "best interest of the client" duty in Standard 2 and also ensures that you satisfy yourself that the client understands your advice and the products and services you recommend. This requires detailed engagement with, and assistance to, the client.[22]

The discussion of Standard 2 in paragraph 29 of the Explanatory Statement to the Financial Planners and Advisers Code of Ethics 2019 addresses when advice and recommendations will be in the "best interest of the client". This Standard emphasises the need for advice and recommendations to be appropriate to the client's individual circumstances (which will require you to take into account the client's broader, long-term interests and the client's likely future circumstances).[23]

This Standard also emphasises the importance of the client properly understanding the advice and recommendations you give, and their implications. It requires you to be satisfied that the client understands:

- the advice and recommendations you give; and
- the benefits of the recommended products; and
- the costs involved in acquiring, holding and disposing of the recommended products; and
- the risks involved in acquiring, holding and disposing of the products, and how you recommend they be managed.[24]

This means that your advice must be clear and simple.[25]

This Standard expressly requires that you have reasonable grounds to be satisfied.[26]

[22] ES:44
[23] ES:45
[24] ES:46
[25] ES:47
[26] ES:48

Example 14: Ineffective Statement of Advice

In advising all of his clients, Frank uses a template statement of advice (SoA) document provided by his licensee.

The document is long and contains educational material and standard risk information relating to a range of advice topics.

At his licensee's insistence Frank is only able to minimally tailor this document for individual clients and, never tailors or removes generic information that is not relevant.

The resulting SoA document is unnecessarily long and includes complex language and concepts that compromise the client's ability to understand the advice.

Guidance

Frank highlights to his licensee that the advice documentation is overly long and complex, and fails to give clear and simple explanations of:

- the implications of the advice or recommendation;
- the benefits;
- the costs; and
- the risks, and how the adviser recommends they be managed.

Frank is duly concerned that using his licensee's prescribed template makes it very difficult for him to comply with **Standard 5**.

In order to overcome the problem with his licensee's documentation, Frank makes sure to highlight paragraphs in the template of particular relevance to each client's circumstances.

He also undertakes tailored explanations and provides additional client education where he has any doubt about the client's understanding of the statement of advice. By tailoring his explanation of the statement of advice to each client, Frank has a reasonable basis for satisfying himself that the client understands the advice and the benefits, costs and risks of the financial products he recommends.

Other considerations

By formally raising the issues with the Statement of Advice template with his licensee, Frank has taken steps to comply with **Standard 12.**

Example 15: Failure to gain client understanding

Isabelle is an elderly war widow receiving the Age Pension and a small annuity that satisfies her needs. She is quite inexperienced in financial matters.

Isabelle subsequently receives a large lump sum inheritance from her sister's estate.

Isabelle approaches her existing financial adviser Grace for advice on investing the money for the immediate benefit of her grandchildren after she dies.

Grace, who knows Isabelle is inexperienced, recommends Isabelle invest the funds in a managed growth fund.

She prepares an SoA that discloses amongst other things:

- the fund is 'not capital guaranteed';
- the balance may fluctuate daily due to changes in unit prices; and
- there is a risk of capital loss on early withdrawal of the investment.

On presentation of the SoA, Grace asks Isabelle to confirm that she understands the recommendations and to sign a document providing her authority to proceed. She complies with the request, then Grace duly implements the advice.

The investment performs badly, and Isabelle suffers significant losses and complains to Grace's financial services licensee that she did not understand the advice provided and that the investment was not appropriate in her circumstances.

Guidance

Grace breaches **Standard 5** - the advice she gave Isabelle appears inconsistent with the client's overall best interest in that it exposed her to significant risk of capital loss on the investment.

Nor, given the volatility, does it seem appropriate to Isabelle's purpose in investing the fund for the immediate benefit of her grandchildren after she dies.

Further, Grace did not clearly explain the risks to Isabelle. She did not take adequate steps to ensure Isabelle understood her advice or the risks. Grace should have been alert to the fact that many clients say they understand when they do not. There may be many reasons for this. The need to test client understanding is magnified with a vulnerable client like Isabelle in this example who has little experience making investment decisions.

Relying on her statement that she understands is likely to be insufficient. Obtaining signed authority to proceed does not cure the failure to gain client understanding. Grace ought to have taken further steps to test Isabelle's understanding before proceeding.

Such steps could include:

- insisting on a longer time for the client to make a decision and on the client taking the advice away before committing;
- encouraging the client to seek input from a trusted friend or family member with no conflicting interest in the outcome, and offering to meet and explain the recommendations to the family member;
- encouraging the client to ask questions of the adviser;
- asking the client to explain back key elements of the advice to the adviser;
- asking questions of the client to test the client's level of understanding of the recommendations being made and the basis for making them;
- presenting lower risk options to the client in the advice to facilitate comparison and effective choice in the client's decision-making; and

- ensuring as far as possible that the client feels equally free to reject the recommendation - to reduce the risk that the client may be substituting trust in the adviser for rational decision-making; and
- recommending client education tailored to the client's capacity to understand.

If you cannot be satisfied your client understands your advice and the benefits, costs and risks of the financial products that you recommend, you must not proceed.

Example 16: 3rd party influence on advice

Jim, a financial adviser, is pleased to be invited to speak briefly at a property wealth seminar. The organiser promotes a range of property strategies and regularly suggests buying property through an SMSF for which Jim receives referrals.

Five attendees subsequently approach Jim to ask him to set up an SMSF so they can implement one of the promoter's strategies. Whilst Jim undertakes a full assessment of each client's needs and circumstances, he is influenced by the fact that each client has attended the seminar and specifically requested an SMSF. He assumes they understand what they want. While he may not think this through, Jim is aware that if he doesn't support all the clients to establish an SMSF, they won't be able to invest in the promoter's strategies and he may not be invited back to speak and will lose referred business.

Guidance

Jim breaches **Standard 5** - he has failed to establish the SMSF recommendation is in the best interests and appropriate to each client.

Other considerations

Jim also breaches **Standard 3.** His interest to receive further referrals from the property promoter conflicts with his duty to act in the best interests of each client. Rather than applying his professional judgement objectively to each client's circumstances, he has let his self-interest prevail.

Example 17: Timeshare

Edna approaches a booth in a shopping centre advertising a timesharing scheme. She accepts an invitation to attend a seminar about the scheme, and then has a one-on-one discussion with a sales representative, who is a financial adviser, about her holiday needs. The adviser has reason to believe it may be marginally cheaper for Edna to book the same accommodation directly rather than through an interest in the timesharing scheme, but he is aware he would not receive a commission for any direct bookings. The adviser does not investigate this any further; the likely price difference is relatively small, and the adviser thinks that the client will benefit personally from the annual prompt to take a holiday under the scheme. The adviser recommends the client purchase an interest in the timeshare scheme, but does not give any information about whether there are benefits the client would get financially in terms of the cost of accommodation as a timeshare owner compared to booking directly and doesn't discuss the financial risk including considering that Edna's personal situation may change.

Guidance

Even if the adviser honestly believes that the advice is in the client's best interests, he has not ensured that the client understands all the benefits, costs and risks of the timeshare product. The adviser has not met **Standard 5** of the Code.

Other considerations

The adviser also has a conflict of interest and duty in breach of **Standard 3**.

Standard 6

You must take into account the broad effects arising from the client acting on your advice and actively consider the client's broader, long-term interests and likely circumstances.

The Explanatory Statement indicates this standard expressly requires you to take into account the broad effects of the client acting on your advice. These effects are not limited to effects on the client. For example, your advice may have implications, not just for the client personally, but also for other family members of the client. These will need to be taken into account, although you will not have a duty to act in the best interest of the family members if they are not clients of you or your principal. Where your clients indicate they only wish to invest in ethical or responsible investments, you will need to consider whether limiting your product recommendations in this manner is appropriate.[27]

This Standard expressly requires you to actively consider the broader, long-term interests and likely circumstances of your client, reflecting section 961B of the Act.

Example 18: Failure to consider long-term consequences Lydia is 5 years away from retirement. She receives advice to establish an SMSF and to purchase a property in the SMSF by taking out a limited recourse loan. Upon retirement Lydia will immediately be reliant on the fund to generate retirement income. The SoA contains a generic reference that the property could be sold if required. It does not address the sale of the property in relation to cash flow projections or the loan term. The advice does not explain how Lydia's retirement income needs will be met.
Guidance Lydia's adviser breaches **Standard 6**. The advice fails to adequately consider the consequences for her if the recommendations are implemented. In the medium term, when she retires and income from her employment ceases, she may not have sufficient income to cover the loan repayments. The advice does not identify the timing risk that she faces at retirement – she may have little control over the timing of her retirement and the timing of the sale of the property may force her to accept a capital loss on the sale. The advice does not plan for these contingency risks.

[27] ES:49

Example 19: Failure to consider long-term consequences in establishing an SMSF

Ambrosia is in her 70s and recently widowed. She has modest retirement assets including a family home valued at about $500,000 and an SMSF with an investment property valued at about $280,000 in it and a small amount of cash.

Ambrosia's late husband established the SMSF shortly before he died, on the advice of her husband's accountant, who provided advice under the accountant's limited financial services licence. However, the rental property has never generated sufficient income for the couple's pension needs in retirement. Ambrosia has little interest in or knowledge of financial matters. 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.

Guidance

The accountant's advice to implement an SMSF would breach **Standard 6** as it fails to take into account the couple's long-term needs for accessible income in retirement.

Standard 7

The client must give free, prior and informed consent to all benefits you and your principal will receive in connection with acting for the client, including any fees for services that may be charged. If required in the case of an existing client, the consent should be obtained as soon as practicable after this code commences.

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.

You must satisfy yourself that any fees and charges that the client must pay to you or your principal, and any benefits that you or your principal receive, in connection with acting for the client are fair and reasonable, and represent value for money for the client.

The Explanatory Statement indicates this Standard requires the client's free, prior and informed consent to all relevant remuneration arrangements for you and your principal. To meet this Standard, the client must be given a clear and simple explanation of the fees and charges, and the benefits you or your principal will receive, that are attributable to you or your principal acting for the client. There is an extended definition of benefits in subsection 4(1) of the Code, to include monetary and non-monetary benefits. The explanation can be given by you or someone else.[28]

Existing clients' consent must be obtained as soon as practicable after the Code commences. Section 2 of the Code states when it commences.[29]

You must also be satisfied that your client understands and agrees to these arrangements, and you must have reasonable grounds to be satisfied.[30]

This Standard prohibits you receiving "third party" benefits for acting for a client (unless the Act expressly allows). This also applies to a relevant provider who is an individual financial services licensee.

[28] ES:51
[29] ES:52
[30] ES:53

However, it does not prevent a corporate financial services licensee from deriving third party benefits because one of its authorised representatives provides advice to clients. Corporate financial services licensees are not relevant providers subject to the Code.[31]

This standard also requires that all fees and charges payable to you or your principal, and benefits you or your principal receive, for acting for the client are fair and reasonable, and represent value for money for your client. This is an integral part of your duty to deal fairly with your client, and in his or her best interests. There is an extended definition of benefits in subsection 4(1) of the Code, to include monetary and non-monetary benefits.[32]

Part 7.7A Division 3 and 4 of the Act includes detailed requirements about remuneration arrangements, including “conflicted remuneration”. The Code does not remove the need to comply with the requirements of these Divisions.[33]

Example 20: Gaining effective client consent to fees and services

Following a cost and obligation free initial meeting, Andy provides his prospective client Angelika with a letter of engagement for her consideration. The letter sets out the various stages of the advice process and all related fees.

The letter of engagement includes multiple consent forms for Angelika to sign, consenting to proceed with each stage of the advice process and the associated fees. Angelika is given ample time to read and understand the multiple consent forms. Andy explains that if as part of his initial advice he recommends on-going advice services to Angelika for a fee, she will be able to opt out of the ongoing advice services at any time and this will be documented in a further agreement with Angelika for his on-going services that he will ask her to sign if she agrees to implement his initial advice.

Guidance

Andy complies with **Standard 7** provided the fees to be charged to the client are fair and reasonable and represent value for money for the client.

Example 21: Client authorisation

Penelope’s process is to obtain her client’s signature on a range of authority forms at the initial meeting. One of the forms is a fee authority form, with the amounts left blank, as they are not yet known.

Guidance

Penelope breaches **Standard 7**. Her clients do not provide informed consent about the fee, as she requires them to each sign the fee authority form prior to an amount being identified and inserted.

[31] ES:54
[32] ES:55
[33] ES:56

Example 22: Referral commissions

Ogden and Kate, a successful young couple, have interests in several franchised retail food outlets based in large shopping centres. They have a young family. They own their own home and they are keen to provide for their daughters' financial futures by adding to their investment property portfolio.

They have decided to sell some of their existing share portfolio and to use the proceeds to take advantage of a cooling investment property market.

Alasdair has been their financial adviser for years and has helped Ogden and Kate borrow money to invest into several investment properties in the past and arranged the couple's personal insurances.

Alasdair reviews the couple's current financial position and cash flow and advises Ogden and Kate that they are in a position to purchase another property to the value of $1.5million. Alasdair refers the couple to Sally-Anne who operates a real estate buyer's agency based on the Gold Coast – Boomer Property. For every completed purchase, Alasdair receives a referral commission of 15% of the agent's commission. Alasdair did not research other properties for sale.

Guidance

Alasdair breaches **Standard 7** by receiving a benefit derived from Boomer, a third party.

Other considerations

The referral commission arrangement breaches **Standard 3** as it creates a conflict of interest and duty between Alasdair's interest in receiving the commission and his duty to Ogden and Kate only to advise, refer or act in their best interest. Even disclosing the commission and obtaining Ogden and Kate's consent will not relieve Alasdair of his duty to comply with Standard 3.

Standard 8

You must ensure that your records of clients, including former clients, are kept in a form that is complete and accurate.

The Explanatory Statement indicates this Standard requires that a relevant provider keep complete and accurate records of the advice and services provided.[34]

Example 23: Transitioning to digital record keeping

A long-term financial adviser is transitioning their client files from paper based to electronic. As part of this process the adviser invests in a document management system that has adequate levels of data security and functionality to ensure compliance with relevant legal obligations.

Importantly for the adviser, the electronic file keeps all records in one place similar to hard copy files, allowing them to easily locate important documents such as final versions of advice documents and client consent forms.

Guidance

The adviser complies with **Standard 8** in relation to transitioning files.

[34] ES:57

Example 24: Accessing client files when the adviser moves Sasha is an adviser with Elfinbank Financial Advice. After completing her professional year, she leaves to join a boutique owner-operated advice firm. Sasha understands she cannot bring her clients with her to her new firm. Nor can she take her client files.
Guidance Sasha has met **Standard 8** - Sasha's obligation to maintain records under Standard 8 in relation to the advice she provided to her Elfinbank clients only extends to the time she remains employed with Elfinbank FA. Before finishing with Elfinbank FA she reviews each client file and updates all her file notes to ensure all her records are complete and accurate.
Other considerations Sasha also provides a signed statement to her licensee confirming she has handed over all client records to the licensee as she needs to comply with the record-keeping requirements in ASIC Class Order (14/923) Record-keeping obligations for Australian financial services licensees when giving personal advice which continue to apply even where a financial adviser ceases to be an authorised representative of the AFS licensee in respect of the period that the records are required to be given or kept.

Standard 9

All advice you give, and all products you recommend, to a client must be offered in good faith and with competence and be neither misleading nor deceptive.

The Explanatory Statement indicates this Standard requires that all financial product advice, and all financial products, offered to a client be offered in good faith. This means that you must act honestly, and in the best interest of the client, in giving the advice and making the recommendations. You will not be acting in good faith if there is something you are aware of, or ought to be aware of, that would lead to the conclusion that your advice is not in the clients' best interests, taking into account the broad effects arising from the client acting on your advice and the broader, long-term interests and likely circumstances of the client.[35]

The Standard also requires that all financial product advice, and all financial products, be offered "with competence". Among other things, this requires that all relevant providers act efficiently, honestly and fairly. Paragraph 912A(1)(a) of the Act requires licensees to "do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly"; this Standard ensures that a corresponding ethical duty applies to all relevant providers.[36]

Finally, this Standard reflects the current law requiring that financial product advice given, and financial products recommended, not be misleading or deceptive.[37]

[35] ES:58
[36] ES:59
[37] ES:60

Example 25: ‘Know your product’

An adviser's licensee has introduced a new financial product to the licensee’s Approved Product List.

The research provided indicates the product is suitable for investors with a moderate risk profile.

Despite reading the research, the adviser does not fully understand the product, the basis of the projected returns and potential risks.

The adviser approaches the licensee and product provider to better understand the product before considering whether or not to recommend it to their clients.

Upon further investigation, the adviser obtains a better understanding of the product and determines that they will consider recommending it only for clients with an aggressive risk profile and surplus cash flow.

Guidance

The adviser has met the obligation in **Standard 9**. As the adviser’s clients will be relying on his understanding of the product, the adviser has a duty to his or her client to duly investigate the product and satisfy him or herself that he or she has sufficient understanding of the product to be able to advise on it.

Example 26: Fixed term investment

Stuart and Tina are a couple in their late 40s with two children in high school. Stuart earns a modest income as a driver, whilst Tina is an acupuncturist and owns a therapies business. Tina has had a good year and has decided to put some money away. She is a balanced investor seeking long term capital growth and obtains advice from Gennady, an adviser with Samsara Financial Services, to invest in a managed fund. The fund is marketed as a fixed interest product with the following features:

- regular, but variable payments to investors;
- widely discretionary investment mandate that includes Australian and international equities as well as US sub-prime loan securities and below investment grade assets;
- neither income, nor capital guaranteed;
- gearing up to 300%; and
- managed by entities registered in the Cayman Islands.

The fund is included as a ‘defensive asset’ in the client’s portfolio.

As the fund is included in Samsara’s approved product list, Gennady did not feel the necessity to understand:

- the nature and extent of the fund manager’s discretions or their potential to influence fund performance;
- the potential effects of the product’s internal gearing; or
- whether as a consequence the fund was likely to remain true to its nominal classification as ‘defensive’ in any but the most favourable conditions.

Although Gennady agreed to undertake portfolio monitoring under the on-going service agreement with the client, the adviser did nothing to monitor the underlying fund assets, nor the fund’s internal gearing ratios.

At the time the fund failed, it was better categorised as a high-risk investment with significant exposure within its mandate to US sub-prime loan securities, below investment grade assets and high levels of internal gearing.

Guidance

Gennady's advice breaches **Standard 9** – he failed to undertake sufficient research and investigation of the product.

As a consequence, Gennady lacked a competent understanding of the product. It was misleading and deceptive to include the product as a 'defensive asset' in Tina's investment portfolio, as the investment mandate gave too much discretion to the fund manager, and the ability of the fund to internally gear and thereby fundamentally change the risk profile of the fund was inconsistent with the classification of the fund as 'defensive'.

Standard 10

You must develop, maintain and apply a high level of relevant knowledge and skills.

The Explanatory Statement indicates this Standard imposes, as an ethical duty, a requirement to develop and maintain a high level of relevant knowledge and skills. For example, if you specialise in a particular area, you should not provide advice outside that area unless you have the necessary skills and competencies to do so in a professional way.[38]

Meeting the continuing professional development requirements (part of the education and training standards—see subsection 921B(5) of the Act and the Corporations (Relevant Providers Continuing Professional Development Standard) Determination 2018)—will assist with meeting this duty.[39]

Example 27: Where competency requires specialist knowledge

Vernon has been with his employer for a long time.

Vernon's super is still with his original and rather generous employer corporate plan. Like Vernon, the plan has survived a number of attempts by new owners to shut it down. Vernon is close to reaching preservation age and is anxious that his employer Earnest Bank might be about to close the fund and prevent Vernon from reaping the rewards for his years of toil. The fund includes a defined pension for life and other specific benefits that would be lost if Vernon leaves the fund before reaching preservation age.

Verity is an adviser with Samsara Life. While she does not have any direct experience with the Earnest Bank defined benefit scheme, she is confident she can work it out. She reviews Vernon's situation and taking her cue from Vernon's anxiety, recommends he move from his existing corporate superannuation fund to a retail fund immediately.

Verity fails to identify and disclose the adverse consequences of the rollover.

Guidance

Verity breaches **Standard 10** – she did not have sufficient knowledge about the defined benefit scheme. To be fair to Vernon, Verity should have guarded against her own over-confidence. She should not have provided advice on the scheme, but should have sought the assistance of another adviser, or referred the client to another adviser with the necessary competency to advise on the scheme.

[38] ES:61

[39] ES:62

Other considerations

Verity also failed to comply with **Standard 9** since she lacks the specialised knowledge to be competent to advise on the particular corporate scheme.

Example 28: Inexperienced adviser

Natalia is a professional with some complex financial advice needs seeking pre-retirement advice including superannuation, the intended sale of a small engineering business, and what to do with some investment properties in her approach to retirement in 3 years' time. Some of the assets are held in a self-managed superannuation fund. The children are children of her second marriage.

Betty recently completed her professional year and has been authorised by her licensee to provide advice without supervision. As it turns out, Betty's daughter plays soccer in the same team as one of Natalia's children. Due to the social connection, Betty is able to quickly build a good rapport with Natalia, enabling her to gain an effective understanding of Natalia's circumstances, priorities in seeking advice and financial advice issues.

Betty quickly realises although she has a basic understanding of SMSFs and estate planning she does not yet possess all the skills and experience she needs to tackle Natalia's complex financial advice issues. She informs Natalia, who is still very keen for Betty to be her financial adviser and doesn't know whom else she can trust for advice.

With support from her licensee, Betty and Natalia agree that Betty will act as the lead adviser for Natalia, but she will have technical supervision from Kate, a Senior Planner with the same licensee. Betty will also undertake some further training on SMSFs and estate planning to supplement her skills development. Kate agrees and insists on attending an initial meeting with Betty and Natalia to ensure she understands first-hand the best way to assist Natalia. They agree there will be no additional charges for Kate's involvement.

Betty's letter of engagement confirms the arrangement with Natalia setting out that although she will undertake the work as the servicing adviser and is accountable to Natalia for her advice, Kate will be supervising her work.

Guidance

Betty complies with **Standard 10** and exhibits the value of competence – by seeking additional technical supervision utilising Kate's experience and by undertaking additional training she ensures the advice and services she provides to Natalia are competent.

Other considerations

Betty also complies with **Standard 4.** She ensures Natalia is in a position to provide her free and informed consent to the arrangement.

Kate complies with **Standard 12**. She cooperates to ensure Betty can meet her ethical obligations whilst supporting her professional development.

Standard 11

You must cooperate with ASIC and monitoring bodies in any investigation of a breach or potential breach of this Code.

The Explanatory Statement indicates this Standard is a positive duty to cooperate with any investigation of a breach or potential breach of this Code by a monitoring body or ASIC. This duty applies in addition to the offences in sections 921M and 921P of the Act.[40]

Example 29: Responsiveness to investigations

An adviser is notified that they will be subject to an investigation by the relevant investigating body. The adviser is confident that they have maintained good records and takes steps to ensure that all relevant documents that they and their licensee hold are readily available to the investigators.

The adviser responds in a timely way to questions from the investigators.

The cooperation provided by the adviser allows for an efficient investigation and swift resolution.

Guidance

The adviser complies with **Standard 11.**

Example 30: Co-operating with investigation

An adviser has been notified that they will be subject to an investigation by the relevant investigating body.

The adviser is concerned about how the investigation will take place and whether the records maintained about their engagement with clients is going to be adequate.

The adviser seeks to limit access to records and provides delayed and unhelpful responses to investigators.

Initially, the adviser denies holding certain documents.

The lack of records means that investigators need to seek alternative information including interviews with colleagues, staff and clients of the adviser. An email trail shows the adviser held the documents the subject of the earlier denial.

Guidance

The adviser breaches **Standard 11**. The adviser is under a positive duty to cooperate with investigations. The adviser's initial denial about holding relevant documents misleads the investigating body.

[40] ES:63

Standard 12

Individually and in cooperation with peers, you must uphold and promote the ethical standards of the profession and hold each other accountable for the protection of the public interest.

The Explanatory Statement indicates that this Standard deals with relevant providers' professional relationships with each other, emphasising that they need to be supportive and aligned to the profession as a whole—being, and being seen to be, a profession that acts ethically and professionally.[41]

One element of this duty affects relevant providers who are acting as supervisors for provisional relevant providers undertaking the professional year (see the Corporations (Provisional Relevant Providers Professional Year Standard) Determination 2018).

This Standard requires that you must provide supervision that is in the best interest of the provisional relevant provider, that is, supervision that actively assists him or her in getting the full benefit of the professional year.[42]

Example 31: Reporting poor advice Marjorie is a busy professional with a modest investment share portfolio. She is seeking a second opinion after receiving advice 12 months ago with FastBroking's financial advisory arm. It appears Marjorie's original adviser has left the company and she meets her newly assigned adviser Darius for the first time. Marjorie is concerned that since implementing the advice, her portfolio has gone backwards. After reviewing Marjorie's circumstances, Darius is concerned the advice originally provided to Marjorie was inappropriate. He reports his concern to FastBroking's compliance team and ASIC. He advises Marjorie she may have suffered losses that may be recoverable against his licensee. Whilst he is keen to help, he points out to Marjorie that since he works for FastBroking, she should get independent assistance to make a claim against FastBroking for compensation.
Guidance The adviser complies with **Standard 12**.

Example 32: Co-operating with the client's new adviser Donna has just taken a new job in her old hometown. It will enable her and her new husband Keith to buy an affordable home near Donna's parents and start a family. Donna explains the move to her financial adviser and requests a copy of her file so she can provide it to a new adviser back home. Donna's adviser provides her with a copy of the file including the fact find, advice documents, current position, and relevant file notes and also offers to engage in a 'handover' tele-conference with the new adviser once Donna has settled in so her new adviser can quickly get up to speed on key strategic aspects of Donna's financial arrangements and goals.
Guidance The adviser complies with **Standard 12.**

[41] ES:64
[42] ES:65

Glossary

Words and expressions used in this guide are defined in the following table

Expression	Meaning
ASIC	Australian Securities and Investments Commission.
Act	the *Corporations Act 2001*.
Authority	Financial Adviser Standards and Ethics Authority Ltd, which is the standards body under section 921X of the Act.
benefits	includes remuneration and both monetary and non-monetary benefits. It does not include the fixed component of remuneration. Variable components, such as bonuses, are included.
client	generally, an employee does not have clients; the employer does. The same is likely to be true for directors of corporate licensees. To ensure that the application of the code will not be evaded, this definition results in the code applying to a relevant provider who is an employee or a director of a financial services licensee as if the provider's clients included the retail clients of the provider's licensee and the retail clients of other relevant providers who have the same licensee.
code	Financial Planners and Advisers Code of Ethics 2019
financial product	defined in Division 3 of Part 7.1 of the Act.
financial services licensee or licensee	a person who holds a financial services licence.
monitoring body	defined in section 910A of the Act
personal advice	defined in subsection 766B(3) of the Act.
principal	a financial services licensee who has authorised the relevant provider to provide, on its behalf, personal advice to retail clients.
provisional relevant provider	defined in section 910A of the Act.
relevant provider	defined in section 910A of the Act.
retail client	defined in sections 761G and 761GA of the Act.
SMSF	self-managed superannuation fund.
supervisor	defined in subsection 921F(2) of the Act.

Financial Adviser Standards
and Ethics Authority (FASEA)

PO Box A255
Sydney South NSW 1235

E enquiries@fasea.gov.au

www.fasea.gov.au