

EXPOSURE DRAFT



Financial Adviser Standards and Ethics Authority Ltd

Financial Planners and Advisers Code of Ethics 2018

Explanatory Statement

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Key information

1. **Summary.** This is the Code of Ethics for relevant providers (financial planners and advisers), made by the Financial Adviser Standards and Ethics Authority, the standards body under section 921X of the Act. Under section 921E of the Act, all relevant providers (including provisional relevant providers) must comply with the Code of Ethics.
2. **Date of effect:** 30 days after this instrument is registered in the Federal Register of Legislation (see section 2).

Glossary

3. Words and expression used in this statement are defined in the following table.

Expression	Meaning
<i>ASIC</i>	Australian Securities and Investments Commission.
<i>Act</i>	the <i>Corporations Act 2001</i> .
<i>Authority</i>	Financial Adviser Standards and Ethics Authority Ltd, which is the standards body under section 921X of the Act.
<i>benefits</i>	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.
<i>client</i>	a reference in the Code to a client, in relation to a relevant provider, includes a reference to the retail clients of the provider's principal.
<i>financial product</i>	defined in Division 3 of Part 7.1 of the Act.
<i>financial services licensee</i> or <i>licensee</i>	a person that holds a financial services licence.
<i>monitoring body</i>	defined in section 910A of the Act.
<i>personal advice</i>	defined in subsection 766B(3) of the Act.
<i>principal</i>	a financial services licensee who has authorised the relevant provider to provide, on its behalf, personal advice to retail clients.
<i>provisional relevant provider</i>	defined in section 910A of the Act.
<i>relevant provider</i>	defined in section 910A of the Act.
<i>retail client</i>	defined in sections 761G and 761GA of the Act.
<i>supervisor</i>	defined in subsection 921F(2) of the Act.

4. References to numbered sections or other provisions are to those sections or other provisions of the Code, unless indicated otherwise.

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Context

Changes to the Corporations Act

5. The Corporations Act was amended in 2017 to provide for improved standards of education, training, ethical behaviour and professionalism for relevant providers (financial planners and financial advisers). Among those changes, section 921E of the Act now requires all relevant providers to comply with a Code of Ethics made by the Authority under paragraph 921U(2)(b) of the Act.

Enforcement of the Code of Ethics

Not a crime or civil penalty

6. Failure to comply with the Code is not a criminal offence, and section 921E of the Act is not a civil penalty provision.

Monitoring bodies' role

7. Under Division 8B of Part 7.6 of the Act, all relevant providers must be covered by a compliance scheme approved by ASIC. Monitoring bodies, also approved by ASIC, administer compliance schemes. Relevantly, compliance schemes must set out:

- how the monitoring body monitors compliance with the Code of Ethics by the relevant providers who are covered by the scheme; and
- complaints procedures; and
- dispute resolution mechanisms.

8. Monitoring bodies have the power to investigate breaches and potential breaches of the Code, and impose sanctions set out in their compliance schemes if they determine that a breach has occurred. Potential sanctions that a compliance scheme may provide for include:

- a warning or reprimand; and
- requiring the relevant planner to undertake additional training or counselling; and
- requiring additional supervision on a relevant provider; and
- requiring specified corrective action; and
- requiring an independent compliance audit of the relevant provider (if it is a licensee); and
- requiring the relevant provider to provide the services to the retail client again at no cost, or to reduce or waive fees.

9. However, the most serious sanction that can be imposed by a monitoring body (for example, if a relevant provider did not comply with a sanction ordered by the monitoring body) is exclusion from coverage of the monitoring body's compliance scheme. Under section 921H of the Act, each relevant provider must be covered by an approved compliance scheme.

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ASIC's role

10. ASIC retains its power to investigate contraventions of the Act, including breaches of section 921E of the Act.

11. ASIC may suspend or terminate the financial services licence of a relevant provider that is a licensee for a breach of the Code (see section 921E (must comply with the Code), paragraph 912A(c) (must comply with financial services laws) and section 761 of the Act (definition of financial services law)).

12. ASIC may ban a relevant provider under subsection 920A(1) of the Act for a breach of the Code if the relevant provider is a licensee (see section 912A(1)(a) of the Act), but its powers to ban a relevant provider who is not a licensee are limited (see paragraph 920A(1)(e) of the Act).

Injunctions

13. The Court may issue an injunction under section 1324 of the Act on the basis of a breach of the Code (which is a breach of section 921E of the Act).

Compensation and damages

14. Under subsection 1324(1) of the Act, any person may recover damages for a contravention of the Corporations Act, including a contravention of section 921E through a breach of the Code.

Preliminary matters

15. Like the Code, this Explanatory Statement is addressed to relevant providers (“*you*”).

16. Appendix A includes a number of case studies, and relates them to various Standards in section 5, to illustrate the operation of the Standards.

Sections 1 to 4: Preliminary matters

17. Section 1 provides that the name of this instrument is the *Financial Planners and Advisers Code of Ethics 2018*.

18. Section 2 provides that the Code commences 30 days after it is registered in the Federal Register of Legislation. This is the earliest commencement date permitted by section 921W of the Act.

19. Section 3 sets out the legislative authority for making the Code: subparagraph 921U(2)(b) of the Act.

20. Section 4 defines “the Act” as the *Corporations Act 2001*, defines **benefits**, **client** and **principal** and refers readers to the definitions of a range of other terms. These are all covered in the Glossary at paragraph 3 above.

21. Subsection 4(2) provides that each provision of the Code is to be given its full effect, and is not to be “read down” by reference to other provisions, unless the Code itself says so.

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Section 5: The Values and the Standards

The Introduction

22. The Introduction to this section provides background to the Code, and describes the context in which the Code is made.

The Values

23. The Values are paramount. They underlie the code—particularly the Standards. It is an ethical duty under the Code to demonstrate, realise and promote these values.

The Standards

24. The Code sets out 12 ethical Standards.

Ethical behaviour

Standard 1

25. 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.

Standard 2

26. 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. It may be described as the fundamental ethical duty.

27. 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.

28. The duty to act in each client's best interests is fundamental.

29. 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?

30. 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; and
- identifies and completes any reasonably apparent gaps in the information; and
- conducts a reasonable investigation of potential financial products; and

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- bases his or her judgments on the client’s relevant circumstances.

31. The ethical duty in Standard 2 is wider than the section 961B 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 the client’s interests and to consider the client’s likely future circumstances. For example, any potential need for a client or a client’s family member to move into aged care accommodation in the near future would need to be factored into any financial advice you give that client.

32. 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.

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

34. Other aspects of the duty 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;
- you must treat all clients fairly, as between themselves. You should provide adequate professional services to all clients, managing your business so that each client has a fair share of your attention, skills and time.

Standard 3

35. The primary ethical duty in this Standard is that you must not advise your client if you would derive inappropriate personal advantage from doing so. The concept of “personal advantage” encompasses receiving benefits (which are widely defined in subsection 4(1)).

36. However, it is not limited to benefits, and covers other advantages that may accrue.

37. This Standard also prevents a relevant provider from acting “in any other manner” for a client if the provider would derive inappropriate personal advantage from so acting.

38. Personal advantage is “inappropriate” when it would be, or would reasonably appear to be, inconsistent with acting in the client’s best interests.

Examples:

- Harry recommends that his client 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 taking the bonus is inappropriate, as the prospect of the bonus would reasonably appear to influence his advice to Fred.

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- Sally has 2 clients, Bill and Ben. Her duty to Bill conflicts with her duty to Ben. In this case, any benefits Sally gets from either Bill or Ben would be inappropriate as, if she acted for either of them, she would not be acting in the other's best interest.

39. This Standard does not catch advantages accruing to a provider's principal. Thus, for example, Sally may refer Bill and Ben to her fellow relevant providers Lewis and Clark, even though they each have the same principal as Sally. Each of Lewis and Clark will need to consider whether he would derive an inappropriate personal advantage from providing advice.

40. Disclosing to the client the 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.

Client care

Standard 4

41. This standard requires that you only act for a client with the client's free, prior and informed consent.

42. 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.

43. Existing clients' consent must be obtained as soon as practicable after the Code commences. Section 3 of the Code defines when it commences.

44. "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.

Standard 5

45. 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.

46. The discussion of Standard 2 in paragraph 29 above addresses when advice and recommendations will be in the "best interest of the client". This Standard emphasises the need for advice and recommendation 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 likely future circumstances).

47. 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

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- 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.

48. This means that your advice must be clear and simple.

49. This Standard expressly requires that you have reasonable grounds to be satisfied.

Standard 6

50. 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. You will also need to consider whether your product recommendations should be limited to so-called “ethical” investments.

51. This Standard expressly requires you to take into account the broader, long-term interests and likely circumstances of your client. For example, any potential need for the client or one of the client’s family members to move into aged care accommodation in the near future would need to be factored into any financial advice you give the client.

Quality process

Standard 7

52. 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), to include monetary and non-monetary benefits. The explanation can be given by you or someone else.

53. Existing clients’ consent must be given as soon as practicable after the Code commences. Section 3 of the Code defines when it commences.

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

55. 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. 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.

56. 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

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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), to include monetary and non-monetary benefits.

57. The Act includes detailed requirements about remuneration arrangements, including “conflicted remuneration”: see Part 7.7A Divisions 3 and 4 of the Act. The Code does not remove the need to comply with the requirements of these Divisions, and a relevant provider may be able to rely on disclosures given under those Divisions to help establish compliance with this standard.

Standard 8

58. This Standard requires that a relevant provider keep complete and accurate records of advice and services provided.

Standard 9

59. 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.

60. 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 licensee 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.

61. Finally, this Standard requires that financial product advice given, and financial products recommended, are not misleading or deceptive.

Professional commitment

Standard 10

62. 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.

63. 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.

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Standard 11

64. 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.

Standard 12

65. 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.

66. 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.

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Appendix: Case studies

Case Study A

Anna and Brian, a married couple, are seeking advice on improving the performance of their superannuation funds. The adviser (Margo) is an authorised representative of Acme Financial Planning Pty Ltd.

Margo advises Anna and Brian to roll over their superannuation benefits from their current funds (not related to Acme) to Acme funds. Margo does not attempt to compare Brian's likely returns if he were to stay in the Acme Fund with those from the Acme Fund. She ignores (or does not address) the increased ongoing fees that Anna will have to pay in the Acme Fund.

Margo has breached:

- Standard 2—her advice was not in the best interest of either Anna or Brian; and
- Standard 3—as Acme received a benefit from the implementation of her advice to switch to Acme funds; and
- Values and Standard 10, as her failure to consider relevant issues (Brian's likely returns, and Anna's ongoing fees) does not demonstrate competence.

Case Study B

Bob, a senior financial planner employed by a large financial institution, advises a number of clients. He recommends strategies or investments that are too risky for his clients' circumstances. He conducts transactions in his clients' names without their authority. He charges an "ongoing advice fee" without providing any ongoing advice. His files are inadequately kept, but he blames this on the poor systems provided by his principal (the financial institution).

Bob has breached:

- Standards 2 and 4 (and, perhaps, 6)—failing to act with integrity and failing to provide advice that is in the best interests of his clients; and
- Standard 3—conducting transactions without his clients' informed consent; and
- Standard 7(3)—an "ongoing advice fee" where there is no ongoing advice is unlikely to represent value for money for the client; and
- Standard 8—record keeping inadequacies. The principal's failure to provide up to date record-keeping systems does not excuse a failure to keep records.

Case Study C

Maxwell and Olivia, who earn moderate salaries, want to buy a property they can use to live in and operate a bed and breakfast in their retirement. The only funds they have available is their combined superannuation balance of around \$300,000. They have a number of debts, including a mortgage over their home.

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Bob, an adviser with Fantastic Advice Pty Ltd, which is a subsidiary of Big Bank Ltd and holds a financial services licence. Bob is an employee and is authorised by it to provide personal advice to retail clients on a range of financial products.

Bob advises a self-managed superannuation fund structure to take out a loan to buy the property (for about \$1.5m) to live in and run the bed and breakfast, and to buy life insurance and income protection insurance (from a related body corporate of Big Bank) at a level that would cover the debt they expected to incur to buy the property. A Big Bank business banker, whom Bob arranges to consult them, tells them they should be able to borrow enough money to achieve their goal.

Maxwell and Olivia sell their home, pay off some of their debts, establish the self-managed superannuation fund (at a cost of \$4,000) and roll over their current balances into that fund. They take out the recommended insurances, at a considerable on-going annual premium cost.

Fantastic charges an up-front fee of \$5,000 and a \$3,000 annual fee for “ongoing advice”. Big Bank receives \$18,000 in upfront commissions as a result of the implementation of the advice. This helps Bob achieve his monthly bonus targets.

Big Bank then tells Maxwell and Olivia that their overall financial situation will not support a loan of the size needed to carry out their plans.

Bob has breached:

- Standards 2, 5 and 6—failing to provide advice that is in the best interest of his clients and failing to take their long-term circumstances and interest into account; and
- Standard 3—acting where he derives inappropriate personal advantage—both in terms of his own bonus arrangements and in terms of Big Bank’s commission arrangements; and
- Standard 7—the fees charged do not represent value for money for Maxwell and Olivia.

Case Study 4

Tom is a provisional relevant provider in the second quarter of his professional year. He is supervised by Sarah.

Fred is seeking advice on superannuation, saving for a home and debt reduction. When Fred comes in for his appointment with Tom, Sarah is held up with another client and can’t sit in on the interview. Tom interviews Fred anyway, not telling Fred that he is on his professional year or that he is being supervised by Sarah. Fred does not mention that he has a disabled son who requires significant care, and Tom does not inquire about Fred’s family circumstances.

Tom tells Fred that there is a great range of products available that can meet all Fred’s needs. He recommends that Fred:

- roll over his existing superannuation to another fund (which has higher charges); and

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- start a savings and credit card debt plan; and
- apply for a range of insurances.

After the interview Tom prepares a Statement of Advice for Sarah to review. She gives it a quick, cursory review it and signs it.

Apart from the breaches of the Act, Tom has breached:

- Standards 2 and 5—his advice was not in Fred’s best interests or appropriate to his circumstances; and
- Standard 4—he did not get Fred’s informed consent to act; and
- Standard 6—he did not explore Fred’s circumstances.

Sarah has breached:

- all of the Standards that Tom has breached (as the advice Tom gave is taken to have been given by Sarah—see subsection 921F(5) of the Act); and
- Standard 2—failing to supervise Tom properly amounts to a failure to act in Fred’s best interests; and
- Not making appropriate arrangements so that she can interview Fred (she is, preferring her current client) is a breach for Standard 2 and also Standard 3; and
- Standard 5—her cursory review does not give her reasonable grounds to be satisfied that Fred properly understands the advice and recommendations.

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