

Consultation Paper

**Financial Planners and Advisers Code of Ethics 2019 –
Standard 3: “You must not advise, refer or act in any
other manner where you have a conflict of interest or
duty.”**

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Background

The Corporations Amendment (Professional Standards of Financial Advisers) Bill 2016 (Bill) approved by Parliament on 9 February 2017 made amendments to the *Corporations Act 2001* (Corporations Act) to raise the education, training and ethical standards of financial advisers by requiring relevant providers (that is, financial advisers providing personal advice to retail clients on more complex financial products) to hold a degree (or higher or equivalent) qualification, undertake a professional year, pass an exam, undertake continuous professional development (CPD) and comply with a Code of Ethics (Code)¹.

In making these amendments the Government noted that recent examples of unethical behaviour and inappropriate financial advice have contributed to decreased trust and confidence in the financial services sector².

Parliament's amendments to the Corporations were informed by the findings and recommendations of a number of independent reviews including the Financial System Inquiry (FSI) Report November 2014 and the Parliamentary Joint Committee (PJC) Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry in December 2014 as well as through consultation with industry stakeholders.

These reports found issues with the current education, ethical and professional standards of financial advisers, and recommended improvements³.

Further, the PJC on Corporations and Financial Services Inquiry into financial products and services in Australia Report (November 2009), stated that the committee found that "*the inquiry into financial products and services in Australia highlighted the sales-advice conflict arising from significant structural tensions that are central to the debate about conflicts of interest and their effect on the advice consumers receive.*" and that "*the historical emergence of financial advisers as a sales force for product manufacturers was inconsistent with expectations that financial advisers provide a professional service that meets their clients' best interests*". PJC Recommendation 11 states that "*professional associations representing individuals in the financial services industry be required to establish codes of ethics that are compliant with the requirements of a Professional Standards Scheme and that are approved by the Professional Standards Council*".

In approving the amendment to the Corporations Act to require relevant providers to comply with a Code of Ethics, Parliament's explanatory memorandum stated:

¹ The Parliament of the Commonwealth of Australia, House of Representatives, Corporations Amendment (Professional Standards of Financial Advisers) Bill Explanatory Memorandum 2016 page 3

² The Parliament of the Commonwealth of Australia, House of Representatives, Corporations Amendment (Professional Standards of Financial Advisers) Bill 2016 Explanatory Memorandum page 4

³ The Parliament of the Commonwealth of Australia, House of Representatives, Corporations Amendment (Professional Standards of Financial Advisers) Bill 2016 Explanatory Memorandum page 6

“The Code sets out the ethical obligations that apply to relevant providers. These ethical obligations go above the legal requirements in the law and are designed to encourage higher standards of behaviour and professionalism in the financial services industry.”⁴

Pursuant to its functions under section 921U of the Corporations Act, FASEA determined the Financial Planners and Advisers Code of Ethics (Code of Ethics) on 8 February 2019 ahead of its commencement date on 1 January 2020. In making the Code FASEA was informed by the Parliament’s legislative amendments including explanatory memorandum, PJC and FSI findings and recommendations and broad stakeholder consultation.

Standard 3 of the Code of Ethics was developed with the intent that relevant providers must not advise, refer or act in any other manner where they have a conflict of interest or duty that is contrary to the client’s best interests. FASEA consulted widely on the draft Code of Ethics as per its legislative requirement between March and November 2018 before finalising the Code in February 2019 when the legislative instrument was registered on the Federal Register of Legislation ahead of its 1 January 2020 implementation. The final wording of standard 3 states:

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

The standard promulgated by FASEA is consistent with subsequent findings by the Financial Services Royal Commission where it was highlighted that the existing regulatory framework where advisers were able to manage conflict primarily by disclosure was not effective. Commissioner Hayne, in his Final Report, wrote:

“Where possible, conflicts of interest and conflicts between duty and interest should be removed. There must be recognition that conflicts of interest and conflicts between duty and interest should be eliminated rather than ‘managed’.”

To facilitate understanding of and compliance with the standard, FASEA released guidance to support its implementation which explains how FASEA expects the standard to be interpreted and applied. This approach is consistent with ASIC (ASIC regulatory guides), APRA (prudential standards guides) and international regulators when releasing regulatory guides to support the implementation and interpretation of prudential standards or laws.

⁴ The Parliament of the Commonwealth of Australia, House of Representatives, Corporations Amendment (Professional Standards of Financial Advisers) Bill 2016 Explanatory Memorandum Page 30

The FASEA guide to interpretation and implementation of Standard 3 provides:

Intent

The intent of Standard 3 is that advisers must not advise, refer or act in any other manner where they have a conflict of interest or duty that is contrary to the client's best interests.

Standard 3 of the Code is concerned with an actual conflict between duties advisers owe their client and any personal interest they have or an actual conflict between duties they owe their client and duties they owe another individual or organisation. This requires advisers to make a professional assessment as to whether their personal interests or other personal duties/relationships are incompatible or at variance with the interests of, and duties owed to their client.

The Code requires advisers making an assessment of conflict to ensure that, before giving advice, they have met the ethical values and standards contained in the Code and to confirm that their client's interests are given priority and are not in conflict with any personal interest or other interests. The adviser must remain alert to changes in facts and circumstance that could affect this assessment and continue to assess conflicts during their advice relationship on an ongoing basis.

The reliance on the professional judgement of advisers in interpreting the Code is in line with modern best practice in many professions and FASEA considers this approach to be realistic, practical and in line with community expectations.

The Code does not seek to ban particular forms of remuneration, nor does it determine that particular forms of remuneration will always give rise to an actual conflict of interest or duty. That said, you should remain open to the possibility that certain forms of remuneration will always fail to meet the requirements of the Code of Ethics.

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

Standard 3 links closely with Standards 2,5 and 7.

Applying the standard

In assessing whether you have an actual conflict, in the first instance, you need to consider the context of the whole of the Code and satisfy yourself that your relationships and arrangements (including remuneration) meet the provisions of the Code including that:

- the advice will be in the best interests of the client;
- the fees and charges (regardless of type) will be fair and reasonable and represent value for the client and are fully understood by the client;
- the client will understand the benefits, costs and risks of the recommendations made; and
- the advice and fee structure will be appropriate for the client.

In order to aid you in assessing whether you have a conflict of interest or duty, FASEA has developed a 'standard for judgement' that is familiar in law and is consistent with that applied in other professions.

The 'standard for judgement' for determining if an arrangement is conflicted and therefore prohibited is that if:

1. A disinterested person (an unbiased third party with nothing to gain or lose from how the question of conflicts is resolved),
2. who knows all of the facts,
3. would reasonably conclude (that is, has good reasons that other reasonable people would find convincing),
4. that the arrangement could induce the adviser to act other than in the best interests of the client then, that arrangement gives rise to a conflict and is prohibited.

In making this assessment the adviser is to imagine standing in the shoes of an ordinary person – *not* the client, *not* a consumer advocate, *not* another adviser, *not* a regulator, just an ordinary person in the street with ordinary intelligence and good judgement.

Second, this imagined, ordinary person has to be unbiased – with nothing to gain or lose from what is decided about whether or not a conflict exists.

Third, this unbiased (disinterested person) should be imagined having at hand (and to understand) all of the relevant facts about what has to be decided.

Whilst the approach of releasing a standard supported with implementation guidance is consistent with that applied by other regulators including ASIC and APRA, a number of stakeholders have not supported this approach with ongoing commentary that standard 3 is not workable and that guidance cannot be legally relied upon for interpretation.

Feedback received from stakeholders during the consultation process for the Code of Ethics 2020 Guide, regarding Standard 3 included varying suggestions from stakeholders to amend the standard which are summarised as follows:

1. No change to the standard, however implementation could be improved by providing clarity that the standard imposes new and higher duties on relevant providers and provide additional guidance with regard to acceptable remuneration models, referral arrangements and relationship breakdowns.
2. Incorporate into the Code of Ethics Legislative Instrument a clear definition of conflict and the intent of the standard as stated in the draft Guide.
3. Amend the standard to reflect the reasonable person test contained in the draft guide and the flexibility that it allows in looking at the materiality of a conflict of interest.

4. Revert to the draft Code of Ethics wording contained in the version of the Code consulted on in November 2018 as follows:

*You must not advise, refer or act in any manner if you would derive inappropriate personal advantage from doing so.
Inappropriate personal advantage is a material gain that an adviser would receive in making a recommendation where an actual or perceived conflict existed*

5. Recognise that existing forms of remuneration including brokerage are a conflict and amend the standard to provide for the existing Corporations Act avoid or manage and disclose conflicts approach.
6. Incorporate wording to specify that timeshare advisers are exempt as per Corps Act 7.7A 12C.

FASEA has considered the feedback received from stakeholders during the consultation process and consistent with its requirement under the Corporations Act s921U(1)(b) to regularly review those instruments, FASEA has decided to further consult on Standard 3 providing stakeholders the opportunity to provide their views on the effectiveness of the implementation of Standard 3.

Although FASEA considered all stakeholder feedback, FASEA has decided not to explore feedback that was not supported by stakeholders in previous consultation processes or not aligned with the Governments and/or FASEA's intention.

In particular, the draft wording of Standard 3, as prepared for the version of the Code consulted on in November 2018 (point 4 above), was considered but ultimately rejected as an option. FASEA has a settled commitment to the principle, confirmed by the findings of the Hayne Royal Commission, that advisers must not advise, refer or act in any other manner where they have a conflict of interest or duty. The former wording fails to give effect to this clear intent. Furthermore, it remains open to the original criticism, made in 2018, that it will lead to difficulty in interpretation given the inherent ambiguity in its wording.

FASEA welcomes stakeholder views on the options presented in this consultation paper as the consultation process on Standard 3.

Consultation on Standard 3

FASEA is committed to preserving the intent of the current Code; namely, that financial advice only be offered by advisers who are free from conflict. FASEA is also open to making changes to the *means* by which this clear intent is realised through the provisions of its Code.

FASEA seeks broad stakeholder feedback through consultation on amending standard 3 in the Financial Planner and Adviser Code of Ethics 2019 ([link](#)) legislative instrument, specifically on the following options for the wording of Standard 3:

OPTION 1: Incorporate FASEA's intent into the Standard

You must only advise, refer or act where you do not have a conflict of interest or duty, being that which could reasonably be expected to induce you to act other than in the client's best interest.

OPTION 2: This option is aligned with Commissioner Hayne's findings

The findings were that, where possible, conflicts between duty and interest should be removed and his finding that conflicts of interest and conflicts between duty and interest should be eliminated rather than 'managed'. It also draws on the established principles of conflicts contained in section 963A of the Corporations Act.

You must not receive any benefit (whether monetary or non-monetary), nor enter into any relationship, that could reasonably be expected to influence the advice you give or the service you provide to your client.

OPTION 3: Retain existing wording

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

Consultation Interests of FASEA

FASEA encourages you to provide feedback on Standard 3 and is interested in your specific feedback on:

1. Which, if any, of the three options, as offered above, you prefer.
2. Other wording you might propose that is clearly for the purpose of realising the current (and continuing) intent of Standard 3, with a focus on making that intent clear and to enable effective implementation.
3. The practical application of options 1,2 and 3 in terms of:
 - a. Consumer experience
 - b. Adviser practice
 - c. Licensee practice
 - d. Guidance

Consultation Process

The consultation process will open on the 3 November 2021 and close on the 1 December 2021. FASEA encourages and welcomes all stakeholder feedback submitted via email to our dedicated consultation inbox: consultation@fasea.gov.au.

Once all feedback has been considered, FASEA will make a final decision and if required make necessary amendments to the Financial Planner and Adviser Code of Ethics 2019 Legislative Instrument and Explanatory Statements.



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