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19 December 2018

Mr Stephen Glenfield
Chief Executive Officer
Financial Advice Standards and Ethics Authority

By email: consultation@fasea.gov.au

Dear Mr Glenfield,

AFA Submission: FASEA Code of Ethics for Financial Advisers

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for over 70 years. Our objective is to achieve *Great Advice for More Australians* and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

The Board of the AFA is elected by the Membership and all Directors are practicing financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting wealth.

Introduction

The AFA supports a financial advice sector wide Code of Ethics as FASEA has been tasked to develop. It is important that the Code has a material effect in terms of financial advisers better appreciating what they are expected to do. It is now over six months since our last submission to FASEA on the draft Code of Ethics. We have observed some improvements, however there are other changes that have added further issues and complications. Unfortunately, it is our view that much of what we recommended, following the first version, or questions that we had raised, have not been addressed. For a Code that will be so pivotal to the operation of the entire financial advice profession, we are very concerned at the lack of detail and clarity in terms of the requirements.

The feedback that we have from some of our members is that it appears that there is not enough financial advice experience and understanding being applied in the development of this Code. We believe that this is relevant with respect to both the terminology and the practicality of what has been proposed. In the absence of that practical appreciation, it is more challenging to realise the complications that a few words may create. We think that this is illustrated by the final sentence in paragraph 50 of the Explanatory Statements, which asks whether 'product recommendations should be limited to so-called "ethical" investments'. A check of the Cambridge Dictionary on the term "so-called" reveals "used to show that you think a word that is used to describe someone or something is not suitable or not correct". Therefore, the choice of wording suggests that FASEA does not fully agree with the incorporation of a reference to "ethical" investments in the Code. We certainly do not agree with the Code being used as a vehicle to influence the selection of investment options. The reality is that this comment, dropped in without any context, has no meaningful place in the Code. Some of these obvious issues make it clear that this draft Code should have been road tested with practicing advisers to see how relevant it was, what the gaps were, and how clear the message was. It is apparent that this has not happened.

The training of advisers on their obligations under the Code of Ethics is a critical part of the implementation of this substantial change program. We cannot see how advisers can be adequately trained on the basis of what has been released. Neither can we see how much of this can be monitored by a code monitoring body. We note and support the inclusion of case studies, however in our view, the case studies largely cover breaches of the law, do not cover all of the Standards and do not address the key areas where critical terminology has been used or where greater detail and practicality may be required.

ASIC Regulatory Guide 183 identifies that codes should deliver stronger consumer protection outcomes and elaborate on, exceed or clarify the law. The role of the Code Monitoring Body is not to oversee breaches of the law, as this is the responsibility of the regulators. However we note that this draft Code seems to have a predominant focus upon the law.

One of the big challenges that the entire financial advice profession faces is the delivery of cost-effective advice in the context of increasing regulatory and cost pressures. With revenue pressure across multiple angles, finding ways to deliver lower cost financial advice is critical. Scaled advice is an important part of the future of financial advice, however this is very much under threat based upon some of the expectations of this Code, including the requirement to push hard for complete information on a client's circumstances or consideration of the broad consequences of any single piece of advice. Another factor that needs to be taken into consideration is whether the Code could lead to an increase in complaints, and as a result, push up the cost of Professional Indemnity Insurance. The inclusion of requirements that are overly subjective such as 'value for money' could lead to increased complaints.

As we have worked through the draft Code of Ethics, we have continued to ask ourselves the question of how each Standard would be implemented by a Code Monitoring Body. This is an important question, as Standards that are unclear with a Code Monitoring Body that cannot police them, will be ineffective and problematic.

We recognise that FASEA has not been instructed to design a code of ethics for licensees, however we appreciate that the conduct at a licensee level is critical in influencing the practices and behaviours of practising advisers and therefore it is important to recognise the role of licensees in this Code. This version of the Code does better reflect on the role of licensees, however there is still a material gap. We believe that it is appropriate to consider some Standards that would be applied at the licensee level or at least are applicable to conduct at the licensee level. It might also be appropriate to have a Standard that more directly encourages advisers to stand up against inappropriate actions by licensees. We also appreciate that some licensee managers are practicing advisers and therefore it is important to recognise the role of licensees in this Code.

We note that the Commencement in Section 2 of the draft Legislative Instrument is noted as 30 days after the Legislative Instrument is registered, which we assume will be either January or February

2019. We also appreciate the discussion in Section 921W of the Corporations Act about not commencing earlier than 30 days after registration, however Section 1546F clearly states that the obligations under the Code (as set out in Section 921E) do not apply until 1 January 2020. Thus, we are concerned about the lack of clarification on the commencement, as addressed in the draft Legislative Instrument and the Explanatory Statement. The actual date of applicability, being 1 January 2020, should be clearly set out in these documents.

Summary of Feedback/Recommendations

As addressed below, our key points of feedback are as follows:

- There is a lack of detail and explanation in terms of the application of the Code.
- The case studies are excessively focussed on breaches of the law and do not explain the application of most of the requirements of the five Values and 12 Standards.
- This Code remains extremely challenging for a Code Monitoring Body to oversee as the subjectivity has not been reduced through appropriate examples or case studies.
- The Code needs to place greater focus upon conduct at the licensee level. This concern was raised in our initial submission, however not adequately addressed in the draft Legislative Instrument.
- The selection of certain words and terms and the implication of those words needs to be considered, or at least subject to greater explanation.
- The requirement to consider 'likely future circumstances' and related requirements is unreasonable.
- The proposal to get consent from existing clients is both unclear and unnecessary.

Code of Ethics - Values

Whilst the AFA does not disagree with the Values as proposed, we do not consider that the inclusion of single words adequately explains their meaning or what is required. In our view more than single words are required to provide meaning and to ensure that a standard universal understanding is adopted. We put this view forward in our 1 June 2018 submission and repeat it now. We were particularly concerned to note that whilst there is a Values section in the Explanatory Statement, the individual Values have not been discussed, elaborated upon, or given context.

Paragraph 23 in the Explanatory Statement discusses the requirement to demonstrate, realise and promote these values. We would like clarification as to what 'realise and promote' means.

Another key point that we make is how these Values play out in terms of their inter-relationship with the Standards. There is very limited reference to these Values in either the draft Legislative Instrument or the Explanatory Statement. We believe that there needs to be more clarity in terms of how the Values influence the Standards and how they align with the Standards. Only one of the case studies makes mention of the Values.

To what extent is a Code Monitoring Body expected to monitor the application of these Values? As an example, how far does an adviser need to go to demonstrate Diligence and how would a Code Monitoring Body monitor the demonstration of diligence?

Glossary

Our feedback on the Glossary is as follows:

- The definition of 'benefits' does not address the significant differences between salaried advisers (where fixed remuneration and bonuses may be relevant) versus self-employed financial advisers, where the benefits aligns with the revenue that the business generates.
- In terms of the definition of 'client', we are unsure why this refers to the retail clients of the provider's principal.
- We note the use of the term 'principal', however we question why this isn't just a reference to the licensee. As we note below, the one key part of the industry structure that is not addressed in this Glossary is that of Corporate Authorised Representatives, who are neither relevant providers nor licensees.

Code of Ethics - Standards

We will proceed with our feedback below on each of the Standards within the Legislative Instrument and the detail contained within the Explanatory Statement.

Ethical Behaviour

Standard 1: You must act in accordance with all applicable laws, including this Code, and not try to avoid or circumvent their intent.

Whilst we support the intent of this Standard, in the absence of an explanation or examples, it is difficult to understand what FASEA means in terms of avoiding or circumventing the intention of the law. Most of the issues that arise with respect to financial advice relate to non-compliance with the law rather than deliberate attempts to avoid or circumvent the law. From our perspective, this Standard requires advisers to comply with the law, which they are already required to do. It is the second part with respect to avoiding or circumventing the law that may be more appropriate in a Code of Ethics. Nonetheless, for there to be material value in this, it requires further clarification.

It is difficult to see how this Standard could be monitored. There would, in most cases, need to be a reasonably high level of judgement applied to make such an assessment. In the absence of a greater level of specificity, this would be a difficult Standard for a Code Monitoring Body to enforce.

We are not convinced that this is a stand-alone Standard and would suggest that it might fit better in the preamble or introduction.

Standard 2: You must act with integrity and in the best interests of each of your clients.

We fully support the intent of the requirement to act with integrity and in the best interests of each client, which we accept is a fundamental ethical duty of an adviser. We note that the Best Interest Duty obligation under Section 961B of the Corporations Act applies at the time of giving advice. Does this Standard apply only at the time of providing advice, or is it a broader obligation?

We have identified a number of concerns arising from terminology used in several of the paragraphs related to this Standard in the Explanatory Statement:

- Paragraph 27: 'also requires you to keep your promises (explicit and implied)'
- Paragraphs 29 and 31: a client's 'likely future circumstances'

- Paragraph 32: 'it will not be enough for you to limit your inquiries to the information provided by the client… inquire more widely…'
- Paragraph 33: 'you are not relieved of the ethical duty merely because the client does not provide enough information, even when asked'
- Paragraph 34: 'managing your business so that each client has a fair share of your attention, skills and time'.

In addressing our first concern, we suggest the use of the word *promises* be replaced with *agreement* or contractual commitment or otherwise reword the sentence so that a relevant provider is not held accountable for an incorrect interpretation that a client has formed based upon a verbal statement with respect to what the client could expect. We are particularly conscious of potential issues that might emerge in terms of discussion of expected investment returns although client misinterpretations may occur across any area of an adviser-client discussion. We also believe that it is important to recognise that commitments may need to change over time as circumstances change.

Whilst we completely agree with the requirement for an adviser to take into account a client's needs; be they current, broad or longer term, we feel that knowing a client's 'likely future circumstances' may be a difficult task, especially when the client often isn't aware of their own future circumstances. The adviser's ethical duty is reiterated in paragraph 31 by the statement 'Standard 2 is wider than the section 961B obligations'. We note the reference to a family member moving into aged care accommodation, which is an example used elsewhere in the Standards. It should be noted that Aged Care advice is a complex and specialist area. The adviser may not have the knowledge to understand the impact of this on other financial matters. Often the key decision is whether to sell the family home to fund the aged care placement or to liquidate other investments. This is largely dependent upon the needs, wants and preferences of the family member moving into aged care, if they are the owner of the property.

We recommend that the reference to 'likely future circumstances' be removed from the Explanatory Statement.

It is also noted that this statement is with reference to a family member, although it is not clarified as to the nature of the family relationship or whether there is any interdependency. Such a requirement might make sense for a spouse where an awareness of the spouse's financial position should be known to the adviser. Knowing the impact of a move into aged care would require an understanding of the financial position of the family member who is potentially moving into aged care. The adviser has limited rights to be asking this question of their client and the client has no rights to disclose this information to their adviser without the family member's permission. This example is, in our view, highly problematic.

With respect to paragraph 32 and the statement that it will not be enough for a relevant provider to limit their inquiries to the information provided by the client, the first point that we make is that this scenario is directly recognised with the incomplete or inaccurate warning requirement in Section 961H. This comment in the Explanatory Statement is not specifically stated in the Standard and seems to be seeking to override the law. What does 'inquire more widely' actually mean?

We also believe that it is important to raise the critical issue of scaled advice and the ability to deliver financial advice in a cost-effective manner. It does not make sense to require the adviser to ask more questions than they need to. It is also necessary to respect the preferences of the client. Often clients want to limit their disclosure of information at the time of the first advice and then be more fulsome in their disclosure at a later point when they are more comfortable with their financial adviser.

Bearing in mind the intent of this Standard, and more broadly the Code of Ethics, paragraph 33 seems somewhat unreasonable in stating that an adviser is not relieved of their ethical duty, because the client does not provide enough information, *even when asked*. At what point should the adviser continue or cease to prod and probe the client for answers? At what point is the incomplete or inaccurate warning (Section 961H) unacceptable? This issue is particularly the case in point when it comes to scaled advice. It is up to the client to determine and choose the scope of the advice that they wish to receive, however Standard 2 suggests that regardless of the client's wishes (for scaled advice), the adviser may be guilty of not fulfilling their ethical duty. Importantly, some ethnic and religious groups demonstrate practices and preferences that mean they are much less willing to be fully open with their adviser about their personal affairs. This requirement may make it difficult to work with certain ethic or community groups.

Importantly we do not support an adviser deliberately restricting their inquiries or unreasonably limiting their consideration of the client's circumstances.

In terms of paragraph 34, the first bullet point reflects the existing Privacy Act obligations. We support the requirement in the second bullet point to treat all client's in a respectful and professional way, however, ask the question of what type of behaviour would not meet the requirement to be respectful? Additionally, many financial advisers are friends of their clients and also socialise with their clients. Does the requirement to treat clients in a professional way impact the things that they can do with their clients who are also friends?

We feel the requirement with respect to each client having a fair share of the adviser's attention and time is problematic and a difficult one to implement from a practical sense, as each client's financial needs and circumstances would vary in complexity. Over what timeframe is this requirement expressed? What if a client operates on the basis where they pay their adviser a retainer to get dedicated and focussed attention when they need it; which might only arise every two or three years. How are they to be assessed during the years when they don't need any advice? Therefore, it is not necessarily practical to give each client the same time, nor is it realistic to treat them 'equally' due to clients' differing financial situation and their objectives. We believe the words 'fair' and 'fairly' should be replaced with 'equitable' and 'equitably' to better reflect the practical reality of servicing clients adequately.

One practical example, which poses complications for this question is where an adviser commits to manage a client's potential future insurance claim, at no additional charge. They are doing this on the basis that they over-service clients experiencing a claim and potentially under-service clients not experiencing a claim. This outcome is in most cases totally aligned to the preferences of all clients.

Standard 3: You must not advise, refer or act in any other manner if you would derive inappropriate personal advantage from doing so.

In our view there are two key elements to this Standard that require greater clarification. They are the meaning of 'act in any other manner' and 'inappropriate personal advantage'. No explanation has been provided for 'act in any other manner' and the explanation of inappropriate personal advantage in paragraph 38 of the Explanatory Statement does not provide enough clarity. In our view the explanation of 'would reasonably appear to be inconsistent with acting in the client's best interests' in paragraph 38 also requires clarification. The first example under paragraph 38 addresses the receipt of a banned payment, which is a breach of the law and therefore less relevant. The second example is confusing as it is not explained why in this case there is a conflict in representing both clients. It is also inconsistent with the conventional approach where there is the potential for conflict between two clients, which would be to choose one client and refer the other client to another adviser. In our view it would be wrong to refuse to assist both clients. This example does not reflect the reality of how such issues are successfully managed.

Paragraph 36 refers to 'other advantages that may accrue' however this is not defined. We request that this be defined and explained in the Explanatory Statement and that case studies are used to explain the application of this point.

In terms of an inappropriate personal advantage, it is important to state up-front that financial advisers are paid accordingly for the services they provide. In consideration of the appropriateness of this remuneration, due consideration should be given to the following questions:

- Did the achievement of a personal advantage adversely impact upon the adviser's obligation to act in the best interests of the client? and
- Was the level of remuneration appropriate in the context of the value provided?

Where the personal advantage did not impact upon the quality of the advice and the level of remuneration was appropriate, then it clearly does not represent an inappropriate personal advantage. Where the nature of the personal advantage did impact upon the appropriateness of the advice then it is reasonable to conclude that it was an inappropriate personal advantage. Where the advice was appropriate and the remuneration was excessive, then we believe this would constitute an inappropriate personal advantage. A distinct definition of the words 'inappropriate' and 'advantage' need to be provided within the Code for greater clarity and understanding of the boundaries.

Another approach in assessing this point about inappropriate personal advantage is whether all remuneration is consistent with the requirements of the Conflicted Remuneration legislation and Regulatory Guide 246 (Conflicted and Other Banned Remuneration). Importantly, where the remuneration is consistent with the conflicted remuneration legislation, does this suggest that the benefits are not inappropriate? This might be addressed as part of a case study.

The inclusion of 'refer' and 'act' in the Standard opens up concerns about the scope of Standard 3. Issues with respect to referrals are necessarily quite different to the provision of personal advice. A referral does not involve advice, although it might need to include a level of due diligence. If any personal advantage is disclosed, then to what extent can the adviser be held accountable for anything that might eventually go wrong as a result of the actions of the person they were referred to? A referral could be to a lawyer or accountant and the benefit could be return referrals.

The word 'act' may apply to dealing or execution only transactions, which may not be the primary intent of this Standard. We also can envisage issues with respect to business owners who also operate accounting, SMSF administration, mortgage broking or other businesses. What impact will this Standard have on them and the operation of these businesses?

We note the first sentence of paragraph 39, which states that this Standard does not catch advantages accruing to a provider's principal, however Case Study A, specifically refers to benefits received by the Principal (Acme Financial Planning Pty Ltd) and Case Study C refers to Big Bank's commissions (related entity). These case studies do not seem to align with Paragraph 39.

Client Care

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.

We are somewhat confused by this Standard, given that it is apparent that you don't act until you have the client's agreement, however we suspect that there is a finer detail here that might be less obvious. We had assumed that this means that you cannot implement until the client provides informed consent. Importantly this comes back to the definition of 'act', and opens up the question of whether this is a broader concept than just acting on the advice. Might this imply that you cannot provide any services, including the provision of advice (a Statement of Advice), until the client has given informed consent in terms of a signed letter of engagement?

It becomes even more confusing when put in the context of the requirement to get existing clients to consent as soon as practicable after this Code commences (the specifics of which we have discussed above). The use of the words 'if required' leaves a great deal of uncertainty. This is not explained in the Explanatory Statement and Paragraph 43 even leaves out the 'if required' element. If the client has previously signed a Letter of Engagement, an Authority to Proceed or an SoA or an Opt-In Notice, then surely they have previously given consent? Thus, we still remain unsure as to when, or why additional consent of existing clients is required. If this is implying that Opt-In notices are not sufficient, then this appears to be seeking to change the law, rather than going above the law. We also question what 'soon as practicable' might mean. If an adviser needed to go through the consent process with the majority of their clients, then this would be a very extensive and time consuming activity that would materially impact revenue generation and client servicing.

Paragraph 43, when referring to commencement, refers to the wrong Section in the draft Legislative Instrument. It should be Section 2, not Section 3. We also assert that commencement should be clearly stated as 1 January 2020, not 30 days after the registration of the Legislative Instrument.

Thus, the question arises as to whether this Standard is seeking to mandate Letters of Engagement? This might potentially have been addressed by the reference to 'terms' in the second bullet point in paragraph 42.

The AFA has long upheld the concept of 'informed consent' whereby advice models and processes are based around educating clients and ensuring that they fully understand and agree with the decisions that they are making.

The inclusion of the words 'free' and 'prior' raise questions with respect to 'free from what' and 'prior to what'. We believe that the intent of this requirement should be that the client has not been coerced into a strategy or product that they are not comfortable with. Paragraph 42 of the Explanatory Statement attempts to explain the word 'prior' as 'before you start to act'. However, it seems problematic, to suggest that it would be prior to the provision of the advice. Prior to the implementation should surely be taken for granted as this is a requirement of the law.

We also make the point that sometimes financial advisers provide services in terms of general advice and execution only dealing. It would appear that there is a risk that general advice and execution only transactions might be inconsistent with this Standard. Would you need to have a letter of engagement before providing general advice or execution only services? That would cause these cost-effective services to be withdrawn by most providers.

Whilst we are concerned about the intent of this Standard, we are also particularly concerned with any potential suggestion that an 'opt in' arrangement needs to be put in place for all existing clients. It seems unreasonable for the client and the adviser to need to redo existing contractual arrangements. This would amount to a significant amount of work to go back to all of their existing clients and seek to obtain their consent and to clearly explain to them again the services and terms provided and the privacy and confidentiality arrangements applicable to them. Ultimately this cost would need to be passed on to these clients, yet there is no obvious benefit for them.

Is it also potentially implied that this process would be required for all grandfathered commission clients?

We recommend the removal of the requirement to get consent from existing clients.

We note in paragraph 44 a reference to a requirement to be satisfied that advisers have reasonable grounds to be satisfied. This requirement is included in the Legislative Instrument for Standard 5, and it has just been added in to the Explanatory Statement for Standard 4. What does 'reasonable grounds to be satisfied' mean in this context?

Disappointingly none of the case studies address this issue of obtaining consent from existing clients and where and when it might be required or not.

Standard 5: All advice and financial products that you present 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 requirement for the advice and product to be appropriate to the individual circumstances of each client seems to be picking up a combination of the obligations under Section 961G, Section 961B(2)(a) and Section 961B(2)(f). This Part of the Standard seems to be repeating the law and therefore we ask the question why it would be included in the Code?

The second part about understanding of benefits, costs and risks is surely similar to obtaining informed consent and related to the disclosure obligations for advice documents. The third part is to have reasonable grounds to be satisfied.

When looked at in combination, this Standard already seems to have been addressed by the Best Interests Duty in Standard 2 and the informed consent requirement in Standard 4. Paragraph 45 refers to elaborating on the Best Interest Duty in Standard 2, however we cannot see how it elaborates.

We note the reference to 'all advice', which could mean general advice and advice to wholesale clients in addition to personal advice to retail clients. In our view the breadth of 'all advice' could be creating unnecessary complications. The Best Interest Duty does not apply to general advice. We would suggest that a reference to "personal advice and product recommendations" rather than "all advice and products".

We are also uncertain with respect to the use of the term 'present to a client'. Does this mean as part of the delivery of a Statement of Advice, or could it be read more broadly to include a reference to any product that you discuss with a client, even where the discussion could be led by the client?

Paragraph 48 requires that the advice must be 'clear and simple'. Regulatory Guide 175 already sets out an expectation that advice should be 'clear concise and effective'. 'Clear' is consistent between the two, however we do not feel that 'simple' and 'concise' are the same thing. 'Simple' may not be possible for a complex product, or a complex client scenario.

The other issue with respect to advisers being satisfied that they have reasonable grounds, needs to be separately addressed. We ask, what would advisers need to have in order to demonstrate reasonable grounds to be satisfied?

Standard 6: You must take into account the broad effects arising from the client acting on your advice and actively consider the broader, long-term interests and likely circumstances of the client.

The Best Interests Duty and Related Obligations contain a number of requirements to understand the clients relevant personal circumstances and to base all judgements on these personal circumstances.

The challenge with this Standard is understanding what the 'broad effects' might be. Similar to the issues raised in the section for Standard 2 (in relation to 'long-term interests and likely circumstances'), we fear that this may be difficult to implement and be unnecessarily costly. The future is inevitably uncertain and financial advisers cannot be expected to foresee all the potential consequences. The reference to long-term is particularly unrealistic. What is the purpose of this requirement? What is the benefit for clients in this Standard? What if the client only wants the adviser to deal with a short-term objective? In that case there should be a focus upon the immediate implications. Neither should advisers be blamed for matters out of their control and visibility.

We note the reference in Standard 6 to 'likely circumstances'. The client's circumstances should be actual rather than likely, so we wonder whether this was intended to refer to likely future circumstances. Although we have previously opposed any obligation based upon likely future circumstances.

In addition, we question whether this Standard might already be addressed by the Best Interests Duty and in particular Section 961B(2)(g), which requires an adviser to take any other step that, at the time the advice is provided, would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances.

We have expressed above in Standard 2 our deep reservations about the example of a family member who might move into aged care. We repeat again, that this is complex advice, involving particular client preferences and if the adviser does not have an awareness of the person in question and the client is ethically bound to protect the privacy of the other family member, then what is it that the Code is trying to achieve?

We also repeat the point above about the implication of this Standard for providing cost effective scaled advice that is intended to meet a specific client need.

We have already made it clear what we think of the last sentence in paragraph 50 of the Explanatory Statement, relating to 'so called "ethical" investments'. This is a confused statement that has no place in the document and just appears to have been dropped in as some form of compromise. We strongly suggest that it be removed.

Quality Process

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 *Corporation 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.

Financial advisers are already required to disclose all benefits that they receive. Clients express confirmation of this by signing the Authority to Proceed. Informed consent goes to a level above this in that it asserts a genuine understanding of all the benefits. Whilst we think that this is an appropriate target, we also note that it does rely upon a level of financial literacy, which a new client may not have fully developed in the early stages of a financial advice relationship.

The requirements set out in paragraph 52 are already addressed in Statements of Advice that are required to disclose all fees and benefits, and have done so for many years. Licensees have developed tables that are included in SoAs that do exactly this. Thus, this does not belong in the code as it is a restatement of the advisers' legal obligations.

We once again seek clarification of the statement that 'if required, in the case of an existing client, the consent should be obtained as soon as practicable after this Code commences'. When this is required, is not explained and it is unclear why previous consent through signing of a contractual agreement, the potential provision of Fee Disclosure Statements, Opt-In Notices, SoA Authority to Proceeds or Terms of Engagement would no longer be satisfactory and require a new layer of consent. What is the purpose and what is the benefit for the client? We remain concerned that this is trying to replace the law.

We note the reference in paragraph 53 to obtaining consent from existing clients as soon as practicable after the Code commences. The Standard uses the terms if required, which is not explained, but inconsistent with paragraph 53 that leaves out "if required". We also restate our views on when the Code commences (in 1 January 2020) and that it incorrectly refers to Section 3 of the draft Legislative Instrument, when it should be referring to Section 2.

We recommend the removal of the requirement to obtain consent for existing clients.

In the context of paragraph 54, what would be required to demonstrate reasonable grounds to be satisfied that the client understand and agrees to the arrangements?

Paragraph 55 seems to imply that it is permitted for corporate financial services licensees to receive payments or benefits from third parties. We contrast this with the statement in the Standard - "Except where expressly permitted by the Corporation 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." Does this mean that a relevant provider can receive payments from a principal or alternatively does this mean that this requirement does not apply to principals?

We note the reference to benefits expressly permitted by the Corporations Act. Certain benefits that may apply now, such as referral fees paid from third parties are not expressly permitted by the

Corporations Act. It is true to say that instead they are not expressly prevented. Referral fees and revenue sharing with a referral partner are not uncommon. Where they are disclosed and agreed to by the client, then we can see no reason why this Code should prevent them, simply because there is no Section in the Corporations Act that specifically states that referral fees are permitted.

The definition of a 'Principal' only applies at the licensee level. In the financial advice context there are three important layers – relevant providers, Corporate Authorised Representatives and Licensees. Licensees are covered through the reference to principals. Relevant providers are also covered, however there is no discussion of Corporate Authorised Representatives or how they might be impacted by this and other Standards.

We believe that this Standard could do more to address the issue of fair value. The words/terms fair, reasonable and value for money as used in paragraph 56 are all relative and subjective with differing meanings being interpreted by each individual. Additionally, how is a client meant to measure and determine value for money for the fees and charges, payable by them? In many cases the value is derived over time, and in some cases, many years.

As discussed previously, we have questions over what timeframe this should be assessed across and also how it might be considered in the context of life insurance commissions where the benefit will go towards the adviser managing insurance claims on behalf of clients, for those clients who have been subject to a life insurance claim.

What might be fair and reasonable for one client, may not be for another and the same basic message applies with representing value for money. We also believe that the use of the words value for money are very subjective and could lead to an increased likelihood of complaints, and a resultant increase in Professional Indemnity Insurance premiums.

We propose the replacement of the term 'value for money' with 'fair value'.

We note the discussion in paragraph 57 that seems to suggest that the Code does not remove the requirement to comply with the FoFA Ongoing Fee Arrangement and Conflicted Remuneration provisions, which no adviser would have assumed. It then makes the statement that the relevant provider may be able to rely on disclosures given under those Divisions to help establish compliance with this Standard. We can only assume that this means that Opt-In notices and Fee Disclosure Statements may meet the needs of this Standard. If that was the meaning, then it would be preferred to have this expressed in a clear and concise manner.

We note that none of the case studies address issues of the need to obtain client consent from existing clients. Given the uncertainty in this area, we believe that this should have been included.

Standard 8: You must maintain complete and accurate records relevant to services (including advice) you provide to each client (including former clients).

The obligations for advice licensees to maintain records are set out in the AFSL's licence conditions and ASIC Class order 14/923, where the obligation is to retain the records for seven years. The AML/CTF legislation also includes obligations to retain records for seven years after ceasing to provide services. In the context of these existing obligations, we are unsure what the benefit is for the inclusion of record keeping as a Code Standard. We also note the fact that this Standard does not express a required timeframe and it could be implied that this obligation is for an infinite timeframe. We cannot see any justification for keeping records beyond the legal requirement. We suggest this requirement does not belong in the Code.

We believe that this Standard has further complications when viewed from the perspective of a salaried adviser who leaves his employer or for a self-employed adviser who has sold his business or book of clients. There is no apparent release from these obligations in these circumstances. The Corporations Act places the predominant obligation for record keeping on the licensee. As soon as this obligation is applied at the financial adviser level, there are a range of complexities that need to be considered, and it is not apparent that this has occurred. Other problematic scenarios may arise such as the purchase of a book of clients where it later becomes apparent that the files are not in adequate shape, or in the case of taking over the files of a deceased or banned adviser.

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.

In our consideration of this Standard, we have referred to the law that may be covered by this obligation. It would appear to us that acting in good faith and with competence is covered by a combination of the Best Interest Duty and related obligations and Section 912A (General Obligations). We are also conscious that the obligation to be neither misleading or deceptive is specifically set out in Section 12DA of the ASIC Act.

Paragraph 59 of the Explanatory Statement states that 'offered in good faith' means that you must act honestly and in the best interests of the client. The obligation to act honestly is a core part of Section 912A(1)(a) of the Corporations Act. The Best Interests Duty obligation is also set out in Section 961B of the Corporations Act. At a finer level of detail, the discussion about 'something that you are aware of or ought to be aware of' in paragraph 59 also seems to align with the 'other steps' obligations in Section 961B(2)(g).

What does the provision of advice or product recommendations that are compliant with the Best Interest Duty but not in 'good faith' actually look like? We also suggest that the word 'offered' should be changed to 'provided' as 'offered' may sound more like a marketing exercise rather than an advice process. We also believe that the reference to 'competence' needs to be explained. Paragraph 60 appears to link it to acting 'efficiently, honestly and fairly' however we believe that this is largely a different obligation.

We note the discussion in paragraph 60 about the effect of this being to place the obligation to act efficiently honestly and fairly on the relevant provider. We believe that this is already the case through the full application of Section 912A, however if this was not the case, then the solution is more likely to be via legislative change rather than via a Code of Ethics.

We believe that this Standard duplicates the law and therefore we question the applicability of including it as a stand-alone Standard.

We note that none of the case studies refer to a matter related to Standard 9, which we think is an important place to clarify what is required and to demonstrate what a breach of this Standard would look like.

Professional Commitment

Standard 10: You must develop, maintain and apply a high level of relevant knowledge and skills.

The AFA supports a Standard that promotes the achievement of relevant knowledge and skills. We have a similar statement in the AFA Code of Conduct. We are conscious that this Standard will apply to all advisers, including those who are new and those who are older and more experienced. We envisage that the requirement for a 'high level' of relevant knowledge and skills may be applied in a manner that restricts new, younger advisers from expanding their range of services. It is important to get the balance right here and it may be that it should focus upon an 'appropriate level' of relevant knowledge and skills to provide the advice that is required.

We note that the reference to relevant knowledge and skills will generate confusion in terms of what is relevant. We believe that it should be expressed in terms of what is relevant to the area of advice that the adviser provides. For the purposes of greater clarity, we would recommend changing this to "Develop, maintain and apply an adequate level of knowledge and skills relevant to the advice you provide." We are concerned about the implications of paragraph 62 for specialists and whether this is unnecessarily prescriptive. We ask why this should impact specialist more than other advisers? To some extent this might be clarified in paragraph 62, however we still believe that this could cause confusion and needs to be clarified.

Standard 11: You must cooperate with ASIC and monitoring bodies in any investigation of a breach or potential breach of this Code.

Whilst we support that relevant providers must cooperate with ASIC and monitoring bodies in any investigation, we question the purposes of including this as a Standard as it is simply restating the law and is otherwise addressed by the powers that ASIC and Code Monitoring Bodies already have. It should also be noted that investigations by ASIC are almost always managed by the licensee, and the financial adviser is probably limited in terms of their impact upon how the licensee contributes to the investigation. We are therefore drawn to the question of what cooperating with ASIC and monitoring bodies might actually require from a financial adviser?

There are no case studies that address this standard and the Explanatory Statement provides very limited clarification.

We fail to understand how this duty applies over and above the law. In our view it is probably better placed in the preamble/introduction of the Code.

Standard 12: Individually and in cooperation with peers, uphold and promote the ethical standards of the profession and hold each other accountable for the protection of the public interest.

In responding to this standard, we certainly accept that more needs to be done to ensure that poor conduct is minimised and the people responsible for poor conduct are removed from the financial advice sector or remediated where appropriate. We support a broad range of measures to encourage other advisers and employees to call out poor conduct in the financial advice sector. This might be extended to include whistle-blower schemes and protections, which have not worked as effectively in the past as should have been the case.

We believe that it is possible to interpret this Standard as either being focused upon working as a profession to assist all advisers to be the best they can be, or alternatively for the profession to do more to remove inadequate advisers. Both angles have merit, however it is unclear what the primary focus of this Standard is. Standard 12 seems to assume a cooperative scenario with peers. It might be more likely to be an uncooperative environment, where the party receiving the feedback from colleagues rejects that feedback.

It seems that this Standard places an obligation on the relevant provider to 'call out' unethical conduct of another relevant provider and if they fail to do so, then they themselves may be in breach of the Code. The requirement to call out peers could damage employer/employee relationships (in the case of salaried relevant providers), where the employee calls out unethical conduct of their employer and if terminated or disciplined, there may be further consequences.

We believe that further clarification and guidance is required with respect to the intent and application of this Standard.

Paragraph 66 introduces the relevance to supervisors, however we think that this link is somewhat tenuous. The concept of the provision of supervision that is in the best interest of the provisional relevant provider opens up a genuine question about how much time a supervisor can devote to a Professional Year candidate and whether inadequate time could breach this Standard. Strangely, despite this specific reference to supervisors in paragraph 66, Case Study 4 which refers to the role of a supervisor, does not call out her conduct as relevant to Standard 12.

We support this Standard however we believe greater clarity is required for financial advisers.

Other Feedback – Case Studies

Our feedback on the Case Studies are as follows:

- Of the four case studies (A, B, C and 4), we note that none of them address Standards 1, 9, 11 and 12 and that only one addresses Standards 8 and 10. The values are only addressed in one of the case studies.
- Two of the case studies relate to employees and case study 4 does not disclose the business model. It is important to note that the self-employed model is the predominant model in financial advice.
- Much of the description is with respect to illegal conduct and not pure breaches of the Code diminishing the effectiveness of demonstrating the value of the Code on advisers' conduct.
- The second paragraph in case study A states "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". This is firstly confusing as it refers to comparing the Acme Fund with the Acme Fund. It is also problematic to discuss likely returns as financial advisers do not predict returns and it would be highly problematic to do this. They might discuss expected returns from asset classes.
- In terms of the assessment of the advice, the failure to disclose an increase in fees is a breach and not acceptable. This is a mandatory requirement under the Product Replacement Obligations in Section 947D. It does, however, not necessarily mean that the advice did not put the client in a better position. The point about not attempting to compare Brian's likely returns also does not mean that this advice was not in his best interests. More information is required to reach these conclusions.
- The reported breach of Standard 3, appears firstly to be problematic in the absence of being able to prove that it was not in the client's best interests and secondly, the reference to Acme is inconsistent with the first sentence in paragraph 39, that states that Standard 3 does not catch advantages accruing to a provider's principal.
- With case study B, 'conducting transactions without his clients' informed consent' does not necessarily result in the derivation of inappropriate personal advantage. We assume that this does not relate to a Managed Discretionary Account arrangement where the adviser can act without the client's authorisation. In any case, there is insufficient detail on whether these transactions are in the client's best interests or whether they generate any personal advantage.
- The reported breach of Standard 3, appears to be inconsistent with the first sentence in paragraph 39 that states that Standard 3 does not catch advantages accruing to a provider's principal, which presumably Big Bank is.

- In large part, case study B provides clear examples of breaches of the law. It may be more useful to present examples that are less 'black and white' and where there is a breach of the Code without breaching the law.
- Case study C is very similar to a case study from Round 2 of the Royal Commission hearings. This advice and conduct is wrong on so many levels and is clearly technically incorrect (an SMSF buying a Bed & Breakfast to live in) and is in breach of the law. With respect to the breach noted for Standard 7, it would be good to clarify if this was because the advice was poor, or because the SMSF fees are higher than would otherwise have been expected. Alternatively, is it as a result of the life insurance commissions?
- Case study 4 (we are not sure why 4 follows A, B and C), presents a case that is so wrong on so many different levels. We cannot see that this delivers great value as it should not happen in the first case and the link to supervision is of limited relevance to the bulk of the existing adviser population. The suggestion that a provisional financial adviser will provide advice in a client interview before he is allowed to provide unsupervised advice, and that the practice would allowed the SoA to be presented to the client in this circumstance is very hard to accept. This is a somewhat extreme example.
- In terms of the breaches in case study 4, we question the breach of Standard 4 by Tom, as it is unclear that he actually got to the point of acting (subject to the clarity on this definition). It is not clear that the recommendation was implemented. Also the noted breach of Standard 2 by Sarah appears to be wrong as it would be difficult to claim that Tom was Sarah's client and Standard 2 appears to relate to obligations owed to the client (this is apparent from the Explanatory Statement).
- We also question why Sarah preferring her current client is a breach of Standard 2 and have absolutely no idea how this could give rise to an inappropriate personal advantage.

We would like to see some of the important terminology explained via the use of case studies. This should include key terms such as:

- Avoid or circumvent their intent.
- Likely future circumstances.
- If required in the case of an existing client, consent should be obtained as soon as practicable.
- Broad effects arising from the client acting on your advice.
- Free, prior and informed consent.
- Value for money.
- Offered in good faith and with competence.
- High level of relevant knowledge and skills

We would recommend these case studies be road tested on practicing financial advisers to remove the discrepancies. We would also suggest that case studies be developed for all Standards with the assistance of practising financial advisers, and that each case study focus on demonstrating how the Code is breached in situations where the law is not broken.

Other Feedback – Explanatory Statement

Our additional feedback on the Explanatory Statement is as follows:

- Paragraph 11 suggests that ASIC may suspend or terminate an AFSL for a breach of the Code. We are not sure that this is implicit in Section 921E, which merely states that the relevant provider must comply with the Code of Ethics

Other Feedback – Draft Legislative Instrument

The second and third paragraphs in the Introduction in Section 5 are identical to the first and second paragraphs in the Preamble of the March 2018 version. Our concern with some of this material remains, including the apparent blame of 'markets' for the inappropriate pursuit of self-interest. We question the importance of adding the reference to 'the market' in this sentence and suggest that it complicates the meaning of this point.

The reference in the third paragraph to renouncing the pursuit of self-interest, seems to suggest some formal pledge. We note that self interest remains an issue in all professions, whether that is medicine or law or others. A complete eradication of self-interest may be an unachievable goal. It may be that the objective is more to do with the prioritisation of the client's interests.

The reference in the fifth paragraph to "they formerly provided a commercial service", appears to disregard the fact that many financial advisers have conducted themselves as professionals for a long time and do not see themselves in the light painted here. In making this point, there needs to be greater clarity in terms of what is meant by a "commercial service".

We are uncertain as to what the intent of this Introduction is. It seems to be positioned from the perspective of being critical of the financial advice profession, however these statements are not reflective of all financial advisers.

Concluding Remarks

We thank you for the opportunity to provide feedback on this draft Code of Ethics. We have raised a number of points above, some of which are with respect to the terms employed and specific wording. We continue to hold the view that this draft of the Code lacks the required specificity of what is required of a financial adviser in the reasonable protection of a clients' interests and lacks a practical awareness of the financial advice environment. In the current form it will be extremely difficult to implement.

We appreciate the importance of prioritising client outcomes, however the Code needs to be readily understood by advisers to achieve the intended objective of improving client outcomes.

The AFA welcomes further consultation with FASEA should you require clarification of anything in this submission. If required, please contact us on (02) 9267 4003.

Yours sincerely,

Philip Kewin
Chief Executive Officer
Association of Financial Advisers Ltd