

## AGENDA PAPER

**Item Number:** 11  
**Date of Meeting:** 8 May 2014  
**Subject:** Update to the Six Months Review of APES 230 *Financial Planning Services*

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**Action Required**       **For Discussion**       **For Information Only**

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### Purpose

To provide the Board with an update on the progress of the APES 230 working party discussions in respect of the issues identified in the six months review of APES 230 *Financial Planning Services* (APES 230) and to obtain the Board's review comments and direction in respect of these issues.

### History and background

The professional bodies submitted a project proposal to develop a proposed pronouncement to replace the current APS 12 *Statement of Financial Advisory Service Standards* in August 2007. The Board established the APES 230 *Financial Advisory Services* (subsequently renamed *Financial Planning Services*) Taskforce to develop the proposed standard.

#### 2008 - Consultation Paper

In 2008 APESB engaged June Smith of Argyle Partners to prepare a Consultation Paper to inform the development of the proposed APES 230. APESB released the Consultation Paper *Review of Miscellaneous Professional Statement APS 12: Statement of Financial Advisory Service Standards* in October 2008 for public comment for a period of 3 months. APESB received five submissions from professional bodies, Firms and Members. The respondents' comments were considered at the May 2009 Board meeting.

#### 2009 - Submission to the PJC Inquiry

In February 2009 the Parliamentary Joint Committee (PJC) on Corporations and Financial Services initiated an inquiry in to Financial Products and Services in Australia to inquire into the issues associated with financial product and services provider collapses that occurred in 2007-08. In August 2009 APESB made a submission to the PJC inquiry as well as appeared before the inquiry. The PJC inquiry issued its report in November 2009. On 26th April 2010 the federal government released an information pack on *The Future of Financial Advice (FoFA)* which was in effect the Government's response to the findings of the PJC inquiry.

### 2010 - APES 230 ED1 issued

At its June 2010 Board meeting the Board approved the issue of ED 02/10 Proposed Standard APES 230 Financial Advisory Services (APES 230 ED1) for public comment.

APES 230 ED1 was closed for comment on the 15th October 2010. APESB received 67 submissions from Members, Firms, commercial organisations, professional organisations and the joint accounting bodies.

### 2011 – Public consultations

The Board considered the issues identified by respondents at the January 2011 and March 2011 Board Meetings. The Board determined to engage in an extensive public stakeholder consultation process during 2011 and considered the various matters that were raised by key stakeholders at the public Board meetings as well as the respondents' comments to APES 230 ED1, and developed a revised APES 230 *Financial Planning Services* Exposure Draft (APES 230 ED 2).

### 2012 - APES 230 ED 2 issued

Technical Staff prepared an *Explanatory Memorandum* for APES 230 ED 2 which documented the background, key issues considered, and the Board's rationale for the key decisions.

The Board issued APES 230 ED 2 along with the *Explanatory Memorandum* in July 2012 for public comment. APESB received 163 submissions from professional accounting bodies, other associations, Members, Dealer groups, financial institutions, consumer groups, the regulator and other stakeholders.

Technical Staff prepared a Technical Analysis Paper and mapping tables of respondents' key issues in respect of APES 230 ED2 for the Board's consideration at the November 2012 Board meeting. The Board considered the respondents' issues and the APES 230 Technical Analysis Paper.

Subsequent to the November 2012 Board meeting, APESB received additional representations from stakeholders and determined to delay the commencement date of the standard from **1 July 2013 to 1 July 2014** to allow stakeholders additional time and also determined to introduce alternative remuneration models in respect of Professional Fees and Third Party Payments.

### **Professional Fees**

APES 230 provides Members with two alternative remuneration methods to comply with APES 230. The first alternative is for a Member to be remunerated on a Fee for Service basis as proposed in APES 230 ED 2. This is the most effective safeguard against threats to the fundamental principles of the Code arising from conflicted remuneration.

The second alternative provides that the Member may charge professional fees on the basis of the Client's assets or funds under management (FUM) as long as the Member adopts specified safeguards to address the threats from conflicted remuneration as follows:

- obtaining written Informed Consent from the Client prior to commencement of the Financial Planning Service;
- making an annual disclosure to the Client; and
- thereafter obtaining written consent from the Client on a biannual basis.

## **Third Party Payments**

APES 230 provides Members with two alternative remuneration methods to comply with APES 230. The first alternative is for a Member to be remunerated on a Fee for Service basis as proposed in APES 230 ED2 and to rebate any Third Party Payments received back to the Client. This is the most effective safeguard against threats to the fundamental principles of the Code arising from conflicted remuneration.

The second alternative allows for a Member who provides a Financial Planning Service in respect of life insurance, other risk contracts and procurement of loans to receive Third Party Payments as long as the Member adopts specified safeguards to address the threats from conflicted remuneration as follows:

- Act in the Best Interests of Clients;
- obtaining written Informed Consent from the Client prior to commencement of the Financial Planning Service;
- disclosing three comparative quotes where available;
- making annual disclosures to the Client on the estimated and actual amount of Third Party Payments received; and
- where applicable, disclosing to the Client the impact of any proposed changes to existing life insurance and other risk contracts and loans.

## **ASIC's Regulatory Impact Statement and Regulatory Guides**

ASIC has released a Regulatory Impact Statement and Regulatory Guides in respect of the administration of the *FoFA* legislation.

A summary of these key ASIC publications is provided below.

### **ASIC's Regulation Impact Statement – Future of Financial Advice: Best interests duty and related obligations**

In December 2012 ASIC released Regulation Impact Statement on *FoFA* best interests duty and related obligations. This document outlines ASIC's assessment of the potential regulatory and financial impact of their administration of the new obligation for advice providers to act in the *best interests of the client* and related obligations in Div 2 of Pt 7.7A in the *Corporations Act 2001*. It outlines the consultation process that ASIC underwent in determining how best to assist those providing personal financial advice to comply with the best interests duty and related obligations.

At its November 2012 and April 2013 meetings, APESB determined that the best interest duty and related obligations from *FoFA* should apply to all Clients in respect of Financial Planning Services, notwithstanding that *FoFA* does not apply to wholesale Clients and advice provided outside of an Australian Financial Services License. All Clients are entitled to be accorded the same duty of care and diligence from Members who provide Financial Planning Services.

### **ASIC's RG 245 on Fee Disclosure Statements**

At the end of January 2013 ASIC released RG 245 Regulatory Guide on Fee Disclosure Statements. This guide applies to new and existing retail clients, with a limited number of items for which ASIC will take no action positions in respect of existing retail clients. It will apply to all fee recipients, i.e. financial planners/advisers from 1 July 2013.

Some of the key requirements include:

- Financial planners/advisers will be obliged to disclose the amount (in Australian dollars) of each ongoing fee paid by the client under the ongoing fee arrangement in the previous year which means that the fees must be stated as dollar amounts, rather than as a percentage of funds under management; and
- Commissions constitute a commercial arrangement between the product issuer and the financial planner and generally need not be disclosed. However, if the commissions are not disclosed then care must be taken in the choice of wording in the fee disclosure statements so that the Fee Disclosure Statement (FDS) does not mislead clients that it is the only payment received by the financial planner. If it is too difficult to determine the breakdown of commissions and advice fees then everything must be disclosed; and
- For commissions that were entered into with the clear consent or at the direction of the client must be disclosed. The mere existence of disclosure in the Statement of Advice (SOA) does not amount to consent.

This guidance from ASIC creates further challenges for financial planners/advisers in receiving conflicted remuneration and strengthens the position of APES 230 by supporting requirements to disclose dollar amounts for professional fees.

### **ASIC's RG 246 on Conflicted Remuneration**

ASIC issued Regulatory Guide 246 *Conflicted remuneration* (RG 246) on 4 March 2013. RG 246 provides ASIC's final guidance to help industry understand the practical operation of the ban on conflicted remuneration and how ASIC intends on administering it. This guidance includes ASIC's definition of what constitutes conflicted remuneration and covers:

- volume-based benefits;
- performance benefits for employees;
- volume-based shelf space fees;
- asset based fees on borrowed amounts;
- transitional provisions; and
- the anti-avoidance provision.

Some key points from RG 246 include:

- the presumption that volume-based benefits are conflicted remuneration;
- examples of benefits that are generally conflicted remuneration include: Commissions, volume-based benefits, and fee discounts; and
- exclusions to conflicted remuneration include: 'grandfathered' benefits; benefits for advice on general insurance and life risk insurance products; consumer credit insurance; and execution-only services.

### **Consideration of Issues**

APESB Technical Staff have completed the following procedures to identify any issues associated with this Standard:

- Consulted with the Professional Bodies to identify whether Members or other stakeholders have raised any issues with the Professional Bodies in respect of APES 230;
- Reviewed the APESB Issues Register to identify whether stakeholders have reported any matters in relation to APES 230; and
- Performed an internal technical review of the Standard.

The issues identified as a result of completion of the above procedures have been addressed in the attached APES 230 Six Month Review Report which was tabled at the April 2014 Board meeting.

### **May 2014 Update**

Two APES 230 working party meetings were held on 10 April 2014 and 17 April 2014. The working party discussed the issues identified in the six month review and developed recommendations which are summarised in attachment 9 (a) APES 230 *Financial Planning Services* Working Party discussions.

Technical Staff have also prepared an 'Application Timeline for the remuneration requirements' in attachment 9 (b) to provide guidance on issues 1.3, 2.2, 2.5 and 2.7.

The key outstanding matter is issue 2.6 dealing with the Best Interests Obligation.

Potential options for the Board to consider are:

1. Leave Best Interests of the Client as per APES 230 and revisit the issue during the Annual Review;
2. Develop a stand-alone Best Interests of the Client that is not linked to the *Corporations Act 2001*; or
3. Develop two levels of the Best Interests of the Client. For example when a Member provides advice as part of a service that is captured by an AFSL then they need to comply with the Best Interests Obligations as per the *Corporations Act*. If they are providing advice that is not captured by or linked to an AFSL then they need to consider a different Best Interests Obligation which is specified in APES 230

In relation to this issue, Technical Staff have obtained a Best Interests Duty-Safe Harbour Checklist form a financial planning practitioner (refer attachment 9 (c)) and applied it in the case of a mortgage or loan product. Based on the review it appears that this document can be modified and be applied in the case of loans and mortgage products to provide comfort that a Member in Public Practice has considered the Best Interests of the Client.

The second option for the Board to consider is whether the Board develops a stand-alone Best Interest Obligation that is not linked to the *Corporations Act*. However, this will mean that for Members who hold an AFSL that they will need to comply with the *Corporations Act* Best Interests obligation as well as the APES 230 Best Interests obligation.

The third option for the Board to consider would be to develop a secondary Best Interests Obligations for Members who are not providing services under an AFSL or linked to an AFSL such as Australian Credit Licensees who provide loans or mortgage products.

The Board's direction is sought in respect of this matter.

### **Staff Recommendation**

The Board note the APES 230 *Financial Planning Services* Working Group discussions and provide the Board's review comments and direction in respect of these issues.

## **Material presented**

- Attachment 9 (a) APES 230 *Financial Planning Services* Working Party discussions;
- Attachment 9 (b) APES 230 *Financial Planning Services* Application Timeline;
- Attachment 9 (c) Best Interests duty – Safe Harbour Checklist (commercial in confidence);
- Attachment 9 (d) Division 2 ‘Best Interest Obligations’ of the Corporations Act;
- Attachment 9 (e) Six Month Review of APES 230 *Financial Planning Services*;
- Attachment 9 (f) APES 230 *Financial Planning Services* Standard; and
- Attachment 9 (g) Basis for Conclusions: APES 230 *Financial Planning Services*;

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**Date:** 5 May 2014