

Proposed Principles to be addressed in APES 230 *Financial Advisory Services*

Scope of the project

The proposed APES 230 *Financial Advisory Services* will specify the key requirements and responsibilities of Members who are involved in provision of Financial Advisory Services (FAS). Similar to the existing APS 12 *Statement of Financial Advisory Standards*, the proposed APES 230 will cover both Members in Public Practice and Members in Business who provide FAS.

Key Definitions

The definitions in the current standard APS 12 *Statement of Financial Advisory Services* and the recently issued New Zealand Institute of Chartered Accountants (NZICA's) *Financial Advisory Engagements* were considered in the development of the following key definitions. It is proposed that the standard will include these key definitions:

Australian Financial Services Licence means the licence granted by the Australian Securities and Investment Commission (ASIC) to a natural person or corporation to perform Financial Advisory Services, including the provision of financial product advice, within the scope of the specific licence conditions attaching to that licence. (APS 12 adapted)

Authorised Representative means a person or a corporation who is authorised by an AFS licensee to perform or deliver *Financial Advisory Services* on its behalf. (APS 12)

Commission means all monetary amounts received from a third party in respect of placement or retention of Client funds or business, and/or purchases or sales of financial and/or risk products, and includes 'Soft-Dollar' Benefits. (NZICA adapted)

Fee for Service means computing professional fees based on the following criteria:

- the complexity of the Engagement;
- the skill and knowledge required for the type of work;
- the level of training and experience of the person necessarily engaged in the work;
- the degree of responsibility applicable to the work, such as risk; and
- the time of all persons engaged in the work.
- It does not include Commissions, asset based percentage fees, production bonuses, or other forms of remuneration that are calculated by reference to product sales or the accumulation of funds under management.

(APS 12 adapted and APESB Consultation Paper)

Fiduciary means the Member's role when providing Financial Advice to Clients, which includes acting in utmost good faith, in a manner that the Member reasonably believes to be in the Client's best interest. (NZICA)

Fiduciary Relationship means the relationship of trust and confidence created by the existence of Fiduciary duties which may be imposed on the Member as part of their professional obligations to act on behalf of the Client. In these circumstances, subject to the Member's overriding professional obligation to act in the Public Interest, the Member shall always put the Client's best interests ahead of the Member's interests. (NZICA adapted)

Financial Advice means any Financial Advisory Service carried out by a Member. These services include, but are not limited to:

- i. Providing advice on financial products such as shares, managed funds, master funds, wrap accounts, margin lending facilities and life insurance carried out pursuant to an AFS Licence;
- ii. The taxation aspects attaching to such advice;
- iii. Dealing in financial products as defined in section 766C of the *Corporations Act 2001*;
- iv. The provision of *Financial Advice* not subject to AFS licensing, such as non product related advice on financial strategies or structures; and
- v. Providing advice and services related to the procurement of loans and other gearing arrangements.

(APS 12 adapted)

Financial Advisory Service means the provision of Financial Advice by a Member in the course of assisting Clients to manage their financial affairs specifically related to wealth and retirement planning, personal risk management and allied advice. It includes the provision of financial services as defined in *Section 766 of the Corporations Act 2001*, and other Financial Advisory Services for which a licence may not be required.

(APS 12 adapted)

Representative means an Authorised Representative of an AFS Licensee, an employee or director of an AFS Licensee, an employee or director of a related body corporate of the Licensee or any other person acting on behalf of the AFS Licensee. (APS 12)

Soft Dollar Benefits means all monetary and, other than insignificant, non-monetary benefits received by a Member from parties other than the Client pursuant to performance of Financial Advisory Engagements. They do not include:

- i. fees derived directly from their Client in respect of such Engagements; and
- ii. referral fees received in the course of referring Clients to other service/product providers, disclosed to the Client by the Member at the time of provision of advice.

(NZICA)

Statement of Advice (SoA) means any written advice to the Client within the specific meaning of section 946A of the *Corporations Act 2001*. (APS 12)

Please note that at this stage the definition of Client and Engagements has been used in a manner that it is also applicable for Members in Business who provide Financial Advisory Services to Clients of their Employers.

Proposed Professional and Ethical Obligations

The professional and ethical obligations in the current standard APS 12 *Statement of Financial Advisory Services* and the recently issued New Zealand Institute of Chartered Accountants (NZICA's) *Financial Advisory Engagements* were considered in the development of the following principles.

Fundamental Responsibilities

The proposed standard will impose professional and ethical obligations based on the following principles and key requirements of the Code in a similar manner to other APES Standards:

- Public Interest;
- Integrity;
- Objectivity;
- Professional Competence and Due Care;
- Confidentiality;
- Professional Appointments;
- Conflicts of Interest;
- Marketing;
- Use of third parties/Experts.

Structure and Coverage

The proposed standard will be structured to address both Members in Public Practice and Members in Business.

ALL Members

Requirements relating to all Members should address the following key areas:

- **Fiduciary Relationship with the Client:**
 - Usually a Fiduciary Relationship exists between a Member and a Client in respect of a Financial Advisory Service Engagement. Accordingly, subject to the Member's overriding professional obligation to act in the Public Interest, the Member shall always put the Client's best interests ahead of the Member's interests.

- The Member shall provide full disclosure to the Client of all material facts relevant to the relationship including disclosure of any conflicts or potential conflicts the Member may have.
- The Member shall take appropriate steps to manage conflicts of interest and to avoid significant conflicts of interest. In certain circumstances where the conflicts are significant the Member shall decline the Engagement.
- The Member shall ensure that information obtained in confidence from the Client is used for the benefit of that Client and not to the benefit of the Member or any other party.
- The scope of the Member's Fiduciary duty will be influenced by the:
 - (a) nature & extent of advice,
 - (b) extent of reliance/trust placed in the Member by the Client,
 - (c) degree of discretion the Member has,
 - (d) circumstances where the Client has given the Member informed consent to enable certain actions or conduct to be undertaken by the Member.

Disclosure to Clients and Prospective Clients

- During the initial phase of a Financial Advisory Engagement, the Member shall disclose all information as required by applicable law, regulation and this Standard. This includes disclosure of information to the Client as required to meet the Member's fiduciary duties.
- The disclosure by the Member shall include:
 - (a) the identity of the person or entity responsible for providing the Financial Advice;
 - (b) the nature of the Financial Advisory Services provided or offered;
 - (c) significant factors that affect or could affect the Member's ability to provide Financial Advice to the Client on an objective and independent basis;
 - (d) the method of remuneration and the nature of compensation and other arrangements the Member has with any third parties that are, or may be relevant to the provision of Financial Advice to the Client.
 - (e) information about any actual, potential or perceived conflicts of interest that may affect the Member's Fiduciary relationship with the Client;
 - (f) where the Member has adopted safeguards to manage or control any identified conflicts of interest, information about the nature of those safeguards and an explanation of the reasons why the Member considers those safeguards to be effective; and
 - (g) information about the nature and extent of any interests, associations or relationships, including family, contractual or agency relationships, whether of a financial nature or otherwise, that have the potential to affect the Member's relationship with the Client, or the Financial Advice provided to the Client.

Engagement Performance

- A Member shall perform a Financial Advisory Engagement based on their knowledge and understanding of their Client's financial needs, objectives and priorities, and relevant personal circumstances.
- The Member shall perform procedures that are adequate to establish a reasonable basis for the Financial Advice provided.
- The procedures performed by the Member shall include:
 - (a) Making reasonable enquiries about the Client's relevant personal circumstances;
 - (b) Making an assessment of the Client's risk profile, financial needs, objectives, priorities and relevant personal circumstances such as risk tolerance, need for regular income compared to capital growth, capacity to service any loans etc;
 - (c) The financial literacy and sophistication of the Client; and
 - (d) Taxation implications.
- The Member should have access to and perform reasonable research on relevant financial markets and products when formulating and developing financial strategies for Clients and making investment recommendations.

Client information, Client Monies and Other Client Property

- Where a Member in Public Practice holds or receives money on a Client's behalf, the Member shall comply with APS 10 *Trust Accounts* and GN3 *Operation of Trust Accounts*;
- The Member shall provide the Client with a statement in writing that ultimate responsibility for accuracy and completeness of information rests with the Client, the Financial Advice given is based on the Member's knowledge of Client circumstances, limitations associated with the Engagement mean the Client should not regard any statements as assertions of fact;
- The Member shall take reasonable steps to protect the security of Client information and property within the Member's control in accordance with the applicable law, regulations and confidentiality requirements of APES 110;

Use of assumptions to develop Financial Advice

- The Member shall develop the Financial Advice, and any recommendations contained in the advice, applying assumptions relating to:
 - (a) Client specific information provided by the Client (such as retirement age, life expectancy and income needs); and
 - (b) relevant economic factors (such as inflation rates, tax rates, investment returns), that the Member reasonably believes are appropriate for the purpose of the advice.
- The Member shall agree with the Client all the significant assumptions that can reasonably be expected to influence the Financial Advice, and document the assumptions used to develop the Financial Advice provided to the Client.

Incorrect or misleading information

- Members shall take reasonable steps to ensure that financial information, projections, forecasts etc. prepared by the Member are reasonable and does not contain false or misleading information, or omit material information.
- Where a Member subsequently identifies an error, omission or misstatement, the Member shall provide a written statement to the Client informing them of the issue and its impact on the previous Financial Advice provided by the Member;
- If the Member subsequently becomes aware that Financial Advice was based on false or misleading information, the Member shall take all necessary steps to withdraw the Financial Advice and provide appropriate notification to the Client;

Non-cash alternative remuneration

- The Member shall avoid alternative remuneration benefits where the receipt of these benefits places the Member's interests in conflict with the Client's interests;
- The Member shall not accept the following benefits under any circumstances:
 - Free or subsidised office rental or equipment, computer hardware and computer software which is commercially available;
 - Free or subsidised attendance (including travel and accommodation), or sponsorship of, conferences or functions of one or more days duration, conducted by a third party, where the principal eligibility is based on or related to business volumes written or held;
 - Cash payments not directly attributable to a direct client action; and
 - Gifts over \$300 in retail value;

- The Member shall record in an Alternative Remuneration Schedule all alternative remuneration benefits received from a third party relating to entertainment, conference attendance or sponsorship that exceed \$300 in value. The Member shall record these items within 14 days of receipt and the relevant records shall be kept for a period of five years;
- The alternative remuneration schedule shall be made available for immediate inspection upon request by Clients within 2 days notice, or as legally required by regulatory authorities and Professional Bodies;
- Specific reference to the availability of the Alternative Remuneration Schedule shall be included in the Member's Financial Services Guide and Statement of Advice;

Quality Control/Documentation

- A Member who is providing Financial Advisory Services shall implement appropriate and effective quality control policies and procedures.
- Members need to maintain appropriate working papers to support the Financial Advice provided.

Estimates and Projections

- The Member shall consider whether the use of an estimates and projections are reasonable in the particular circumstance. Where estimates and projections are used, the Member shall advise the Client in writing of the reason for their use and the basis of calculation of the estimates and projections.

Members in Public Practice

Requirements and guidance relating to Members in Public Practice should address the following key areas:

Professional Engagement matters:

- The Member shall issue an Engagement Documents in accordance with APES 305 *Terms of Engagement*.
- The Engagement Document should specify the scope of the Engagement including whether it is a Comprehensive Financial Advisory Service (i.e. development and implementation of a Financial Plan), Limited Scope Financial Advisory Service (i.e. review service) or Other Financial Advisory Service (i.e. execution only service). Refer APESB Consultation Paper for further details on types of Engagements.
- The Member shall return Client property in accordance with the terms agreed in the Engagement Document.

Professional independence:

- Where the Member provides independent Financial Advice, the Member shall comply with the independence requirements stipulated in applicable law (for example, section 923A of the *Corporations Act*), regulation and this standard.
- The Member shall avoid all conflicts of interest or situations where advice is constrained or biased in favour of particular financial products or product providers.
- Where a Member provides advice that is restricted in scope, the extent of these restrictions and its effect on the Member's independence shall be disclosed to the Client.
- The Member shall consider potential threats created by business relationships or any other financial involvements which threaten a Member's objectivity;
- The Member shall disclose to the Client all financial and non financial benefits that accrue to the Member from the sale of financial products to the Client;
- The Member shall make recommendations that are appropriate to meet the Client's financial needs & objectives. Recommendations to replace financial products shall only be made where the relevant matters are discussed fully with the Client and the change meets the Client's financial needs and objectives and when there is a benefit to the Client.

Professional fees

- The Member shall adopt a Fee for Service model when providing Financial Advisory Services to Clients;
- The Member shall ensure that the Client is advised of the total cost of the Financial Advice and the Fee for Service is a fair reflection of the value of the services performed;
- The Member shall not discount initial fees where there is an intention of recovering such fees through additional services or higher charges in the future;

Disclosure and reporting of Professional Fees

- The Member shall disclose all financial and non financial benefits received or receivable by themselves, their AFS Licensee or a third party in a clear, concise and transparent manner. This should be done in the initial phase of the Engagement to enable the Client to make informed decisions regarding any potential conflicts and thereafter on an annual basis;
- The Member shall ensure the Client receives a fee schedule describing ongoing services offered, description of ongoing fees, and the basis of calculation of such fees;
- If there is a material change to the basis of calculation of Professional Fees, the Member shall prepare and send the new basis of calculation to the Client;

Members in Business

- It is important to note that the principles applicable to Members in Public Practice (including the principles on remuneration) are principles that should be applied to all members who offer Financial Advisory Services to the public. This includes Members in Business who work as employees of financial institutions and offer Financial Advisory Services directly to the public. The practical problems arising in applying these principles to Members in Business need to be considered when developing the proposed Standard.