APES 230 SUBMISSION

Count Financial Limited

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APES SUBMISSION

1. INTRODUCTION & EXECUTIVE SUMMARY

Overall, Count Financial (Count) supports the APESB in your objective to increase the professionalism of providers of financial advisory services, and commend the intentions behind APES 230. We are in total agreement with Australians receiving quality financial advice – being a key national priority.

We are also dedicated to ensuring that any standards which impact on accounting professionals providing financial advice are equitable and in the interests of clients, the profession and the financial services industry as a whole.

However, Count has some fundamental concerns with Exposure Draft APES 230, including the following:

- The Federal Government has invested substantial effort into various reviews of the financial advice, wealth management and superannuation sectors (especially the Ripoll and Cooper Reviews) and the taxation review with elements relating to superannuation (the Henry Review). The Government has already proposed major reforms to the financial advice industry – especially through the *Future of Financial Advice* (FOFA) reforms announced on 26 April 2010, and a process for consultation and a timetable for implementation. Given the extensive reviews and continuing consultation by Government, we submit that it would be appropriate for a redrafted version of APES 230 to be considered after the Government process has progressed rather than to pre-empt this process;

- The proposed implementation date of July 2011 poses significant barriers to the practical implementation of any suggested changes and precedes similar changes proposed under the FOFA implementation date by 12 months. We therefore submit that the proposed date is inappropriate and should be carefully reviewed;

- APES 230 introduces fiduciary duty obligations in a manner which pre-empts the very important fiduciary duty obligations being proposed by Government, and which are still being fully defined. Financial advisers already have fiduciary duty obligations to clients, and the Government has proposed that these responsibilities be codified in the Corporations Act, with a shift from a negative fiduciary duty obligation test to a positive obligation. There are important definitional issues to finalise. We submit that APES 230 inappropriately pre-empts this process, and may result in a fiduciary duty obligation different to that defined in the Corporations Act. This is also likely to result in unnecessary confusion which can be easily avoided.

- As articulated in Section 2.4 of our submission, there is ample research and expert commentary to support the view that principles-based legislation (sometimes referred to as outcome-oriented legislation) is more effective than rules-based legislation. So it is with standards – with a principles-based approach being more effective than a rule-based approach. In particular, in a profession, standards which focus on behavioural norms are more effective and appropriate than rules-based approaches, which tend to be more oriented to 'form over substance' and have less focus on behaviour and professional integrity. In crucial areas, APES 230 adopts a rule-based approach rather than principles-based;

- An important example where APES 230 is prescriptive or rule based is in the definition of appropriate remuneration models, and the definition of appropriate Fee for Service models. In the introduction to APES 230 ('Key Requirements and guidance in ED 02/10') it appears that the precepts on permitted remuneration models are based on the presumption that certain remuneration models are inconsistent with fiduciary obligations. We submit that this underlying presumption is flawed, and we include a Barrister's legal opinion in support of this contention. If the APESB accepts this contention, there are sections of APES 230 which require material reconsideration and also redrafting;

- We submit that an accountant member who is a financial adviser can serve their professional and fiduciary obligations to clients with a range of fee models by acting in clients interests (with this definition to be reinforced in statute), ensuring that they don't violate the *profits* test and the *conflicts* test, operating with transparency and full disclosure, and operating with objectivity and total integrity (as required by APS 12). Imposing additional responsibilities beyond that is both inappropriate and detracts from the principles-based approach;

- Based on the foregoing, we submit that the most appropriate 'fees for service' model is that agreed between the accountant financial adviser and their client, providing it is consistent with their fiduciary obligations and there is total transparency and disclosure. Permitted fees models would include hourly fees, fixed fees, and asset based fees, and often a combination of the foregoing. It is not for APES 230 to mandate permitted and non-permitted fee models when the basis for any prohibition remains flawed and there is little or no corresponding benefit to cliehnts. We submit the proposed prohibition of asset based fees should not be accepted, and include arguments in this submission as to why these are a legitimate fees model;

- We submit that Informed clients should be able to exercise choice, and the proposed standard, APES 230, would deny such choice;

- One vexatious issue that the Government has been wrestling with in the FOFA reforms is the issue of commission payments for life insurance, due largely to a significant concern that banning commissions would exacerbate the very real problem of underinsurance. We are concerned that APES 230 does not have regard to these concerns. If the Government understands the difficulties in this sector, why don't the sponsors of APES 230? We submit that commission/brokerage on risk insurance and lending be permitted providing accountant based financial advisers are meeting fiduciary duty obligations and APS 12 professional obligations;

- Further there is a presumption in APES 230 in the areas of lending and insurance that commission costs could be readily stripped out of products and reflected in consumer pricing. This is far from likely to occur and involves a degree of misunderstanding in our view. For example, if lenders were to strip out brokerage from loans, and were to reflect these in product pricing, then the banks would have major channel conflict issues between their proprietary branch channels and the broker channel, as the pricing of their loans would appear cheaper for the latter (before the accountant financial adviser applied their fees). This would be unacceptable to the bank, which would therefore need to equalise loans product pricing across channels. This would then effectively increase the price for loans which are sourced through independent advisers/brokers, and reduce the portion of loans

implemented through the independent advice channel and there would be a diminution in the independence of advice and choice for consumers;

- Good legislation avoids retrospectivity – so too should good standards. APES 230 involves retrospectivity, and seeks to over-ride and violate current commercial legal agreements and obligations (e.g. truncating trail commission and brokerages on business written prior to the implementation date of APES 230);

- A potential risk with any proposed legislation, regulation or standard is the vexatious issue of '*unintended consequences'.* We understand that part of APESB's role is a *public interest* role, and we outline in our submission that one of the unintended consequences of APES 230 could actually be a degradation in serving the public interest, largely due to APES 230 shifting the portion of overall financial advice away from professional accountant financial advisers

The Accountant Financial Adviser Coalition (AFAC) of which Count is a key member, has surveyed members to determine their views on key issues explicit or implicit in APES 230, the results of which are contained in Appendix 1. This was a significant survey and we commend the APESB fully review these survey results.

There are those in the accounting profession who appear to be adopting an approach of lecturing the APESB on its role, and exhorting professional service bodies to effectively 'stiffen their backbone' to act in the public interest.

We request and exhort the APESB to give deep consideration to the complex issues associated with the Exposure Draft, and to consult as extensively as has the Treasury and Government on the Future of Financial Advice reforms. The public policy makers appreciate the complexities, and we submit they require extensive analysis and an understanding of the range of unintended consequences.

2. HIGH LEVEL COMMENTS

2.1. APESB's Role

According to APESB's website, *"all Australian professional accountants have a responsibility to act in the public interest and are expected to act with objectivity and integrity in their dealings with investors, governments, clients, employers and employees and when undertaking work or providing advice. The APESB issues standards that outline the responsibilities of professional accountants to act professionally and ethically when they are performing their role."*

Based on APESB's Policies & Procedures Manual, "*one of the primary objectives of Accounting Professional & Ethical Standards Board Limited (APESB) is to develop and issue in the public interest, professional and ethical standards and other pronouncements that will apply to members of the professional accounting bodies."*

From the above, we understand that a key role for the APESB is to develop and issue standards in the public interest, and to guide accountants in the fulfilment of their professional obligation to act in the public interest and to act with objectivity and integrity. A key issue in assessing the Exposure Draft APES 230 is whether it serves this 'public interest' test, and whether it creates any additional obligation on accountants beyond the

objectivity and integrity obligations by which they are already bound under APS 12. As explained below in Section 2.3, we submit that there are unintended consequences associated with the implementation of APES 230, which may actually be inimical to the APESB's public interest mandate.

2.2. Objective of Exposure Draft APES 230

In the introduction to the Exposure Draft APES 230, it is stated that:

- *"Accounting Professional & Ethical Standards Board Limited (APESB) proposes to issue the Standard APES 230 Financial Advisory Services setting out mandatory requirements and guidance for Members who provide Financial Advice. The proposed standard will supersede the existing APS 12 Statement of Financial Advisory Standards.*

- *The proposed APES 230 includes mandatory requirements and guidance in respect of:*
  - *Fundamental responsibilities of Members;*
  - *Fiduciary responsibilities of Members;*
  - *Professional Independence;*
  - *Terms of the Financial Advisory Service;*
  - *The basis of preparing and reporting Financial Advice;*
  - *Client's information, monies and other property;*
  - *Fee for Service;*
  - *Soft Dollar Benefits; and*
  - *Documentation and quality control.*

  The fundamental principles in the proposed APES 230 ED are that Members who provide Financial Advisory Services act in a Fiduciary Relationship (putting their Clients' best interests ahead of their own interests) and that in so doing they must remove conflicts of interest, particularly those conflicts caused by certain types of fees and remuneration.

  This standard proposes that Members who provide Financial Advisory Services must only charge Clients on a Fee for Service basis (as defined in the standard). Such a Fee for Service minimises conflicts of interest because it is not calculated by reference to products sales or the accumulation of funds under management.

  Consequently, this standard proposes that Members who provide Financial Advisory Services must not use practices that cause conflicts of interest (or perceptions of conflicts of interest) such as Commissions, percentage-based asset fees, production bonuses and other forms of fees and remuneration that are calculated by reference to product sales or the accumulation of funds under management.

  As a result, Members create relationships of trust with their Clients, which is the central feature of any professional relationship.

  It is proposed that these requirements will apply to all new and existing Clients (including those from whom trailing income is being received) of Members from the commencement date of this standard."

The broad intent and objective of APES 230 – i.e. quality, objective and professional financial advice – is to be applauded.

Unfortunately, the objective of quality, objective and professional financial advice is poorly translated into the drafting of APES 230, including the following:

- Inclusion of components in this standard which do not properly reside within APES 230 (e.g. fiduciary obligations, professional independence) – these principles or standards are either covered elsewhere in the accounting professional standards (e.g. in APS 12) or are currently subject to Government determination (e.g. the precise positive fiduciary duty obligation to be incorporated into the Corporations Act)
- As we seek to demonstrate below, especially in Section 2.7, the precept that certain remuneration models are incongruent with fiduciary duty is flawed. This is a major issue for the standard as this misconception is a fundamental foundation in the drafting of key sections of the Exposure Draft;
- The objective needs to be reasonable and professional identification and management of conflicts, rather than total avoidance of conflicts as inferred above. The reality is that any remuneration model (including hourly based billing) has the potential for conflicts – the key issue is how professionals manage such conflicts in the client's interest.

2.3. Comment on the APES 230 Objective & Potential Unintended Consequences which may be inconsistent with APESB's Objectives & Intent

The **broad** objective of the ED – to ensure quality and objective advice delivered by professionals which is in the client's interests - is to be both supported and lauded. The issues arise from the ED moving beyond principles to prescription, and prescription based on certain foundations (e.g. that certain remuneration models are inconsistent with fiduciary duty) which are flawed (based on legal opinion).

Unintended consequences: the effect of APES 230 will most likely be to diminish the portion of financial advice delivered by accountant based financial advisers (because they are placed at a competitive disadvantage) and hence diminish the portion of advice delivered by professionals –this appears to be inconsistent with APESB's public interest responsibility.

Behavioural economics and behavioural finance is an important consideration here – these are defined as follows (per Wikipedia):

> *"**Behavioural economics** and its related area of study, **behavioural finance**, use social, cognitive and emotional factors in understanding the economic decisions of individuals and institutions performing economic functions, including consumers, borrowers and investors, and their effects on market prices, returns and the resource allocation. The fields are primarily concerned with the bounds of rationality (selfishness, self-control) of economic agents. Behavioural models typically integrate insights from psychology with neo-classical economic theory."*

These are important considerations because people (clients) often make decisions more on emotion and perceptions than rationality. There is anecdotal evidence to suggest that many clients eschew fee models, especially fixed fee models, which may actually be cheaper for them than other fee models, because they *perceive* such fees to be higher.

The consequence is that they would then seek out a financial adviser who has no imposed limitation on their fee models but who does not have the same professional status and expertise as the accountant based adviser.

By enforcing certain remuneration models, an uneven playing field is created with regard to the provision of financial advice. Clients who potentially cannot afford a fixed fee financial advisory service, may be priced out of obtaining advice, or may seek advice from an alternative source operating under a different fee structure. Whilst the accountant may consider themselves (and in fact be) the ideal provider of financial advisory services to a particular client, in reality they may be placed in a position where those services cannot be provided due to the restrictions placed on them as contained in this ED. For those smaller practices this represents an impediment to providing advice services, and in fact they may look to move away from this specialist area to more traditional accounting services. For financial advisers in this position, they are placed in a difficult situation as they want to service their clients to the best of their ability and provide ethical, quality advice - however may be unable to do so under certain prescribed fee models. If this occurs, where will clients proceed for advice?

Another likely consequence is that, in fully following the prescriptive detailed processes outlined in APES 230, and determining the corresponding fixed dollar fees, an accountant based financial adviser will become priced out of 'middle Australia' (partly driven by *perceptions* of fixed fees), and therefore that 'middle Australia' is denied access (or their access reduced) to accountant based financial advisers.

We submit that this likely outcome is inconsistent with the APESB's public interest role.

Also, what of a situation where an accountant operates with other non-accountant financial advice providers within a financial planning practice? Is the accountant under a different fee charging regime than his or her colleagues?

We submit that a number of areas in APES 230 as drafted would not assist with the development and professionalism of the financial advice industry, and likely does not meet the objectives of the standard in ensuring the professionalism of accountant based financial advice. In fact APES 230 will lead to division in the advice industry due to the proposed implementation of this uneven playing field.

It is our belief that this standard should be focussing on ensuring professionalism in the industry (which we support) through the implementation of statutory fiduciary obligations (in line with Government reforms), rather than simply placing restrictions on commercial business arrangements which will be suitable for some clients.

The accountant financial advisers that are part of Count regard themselves as absolutely focussed on providing advice services to clients which are in the client's interest.

2.4. Principles based vs. regulatory based arguments

There is significant research and expert commentary available on the relative merits of principles based regulation vs. rule based regulation.

Burgemeestre, Hulstijn and Tan provide a very interesting overview of the respective approaches in their research paper[1] "Rule-based vs. Principles-based Regulatory Compliance" and open their paper as follows:

"In the domains of accounting [2,20,9] and law [10,15,16,8,14] there is a long standing debate about the relative merits of rule-based versus principle-based regulatory systems."

In the 2008 Business Law Journal[2], Cristice Ford explains the significance and wisdom of "principles-based" securities regulation. It canvasses the shift in the UK Financial Services Authority (FSA) to a more comprehensive principles-based regime since 2003 and contrasts its approach with rules-based approach embodied by the Sarbanes-Oxley Act in the United States. The paper references a McKinsey & Co. report commissioned by the New York City Mayor, Michael Bloomberg, which blamed American over-regulation for the City's continuing financial sector woes. It further states that *"the London Stock Exchange has argued that its superior principles-based approach – not lax standards and not simple distaste for Sarbanes-Oxley Act requirements in the United States – was the reason behind the historic shift."*

The paper goes on to canvas the emergence of principles-based securities regulation in Canada, starting in British Columbia.

As stated by John Tiner, CEO, FSA[3] "Principles-based regulation is essentially about outcomes or ends, while rules-based regulation is about means." Principles-based regulation allows firms to decide how best to achieve required outcomes and, as such, it allows a much greater alignment of regulation with good business practice.

As for legislation and regulation, there are two key philosophical approaches to standards setting – principles-based vs. rules-based.

Principles-based standards are based primarily on reinforcing norms for professional behaviour; rules-based approach are based on means and detailed rules. Arguably, one approach is more focussed on 'substance', the other on 'form'.

Principles-based standards are arguably more comprehensive and all-embracing than rules-based standards because they focus on (professional) behaviour, rather than trying to cover all conceivable details and eventualities through prescription-based standards. The latter is not realistically possible.

What is the more effective approach for standards setting for the accounting profession? We would submit that this is principles-based. For example, this is the approach in APS 12 (especially the principles of "integrity" and "objectivity") and APES 320 (quality assurance).

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[1] Burgemeestre, Hulstijn and Tan "Rulebased vs. Principles-based Regulatory Compliance"
[2] 2008 Business Law Journal
[3] John Tiner, CEO, FSA "Proinciples-based regulation is essentially about outcomes or ends, while rules-based regulation is about means."

APES 230 has elements of principles-based standards. For example in Section 3 – Fundamental Responsibilities of Members - which are positive, but the effectiveness of APES 230 is then negated by straying inappropriately into prescription - for example in Section 7 (The basis of preparing and reporting Financial Advice) and the interaction of the definition of Fee for Service (in the Definitions section) with Section 9.

We submit that APES 230 should be substantially re-drafted to be a principles-based standard. We believe a principles-based approach will be more effective in assisting APES 230 achieve its intended objectives.

2.5. Alternative Fee Models, Merits & Demerits & Potential Impact of APES 230

Research from Investment Trends on the provision of SMSF advice, indicates that 40% of financial planners fees relating to SMSFs derive from asset based fees for service, and 39% from 'fixed price' fees for service. It is important to note that this research relates to SMSF clients only, and the relativities would shift strongly to 'asset based fees' if all clients were included.

The key alternative fee models are:

- Time based Fees (hourly charging)
- Fixed fees – either for initial strategic advice and implementation services, or
- Asset based fees – usually for ongoing service/advice, or
- Some combination of the above

There is no 'one size fits all' pricing model, and consideration needs to be given to allowing flexibility in fee charging regimes for different commercial models, and different client relationships (and the type of advice that is being provided as part of that relationship).

Financial advisers and clients may prefer asset based fees (or a combination) to give greater client/adviser alignment particularly where the advice given relates to portfolio management. A not unusual hybrid fee model is fixed pricing for strategic advice, and, after that, asset based pricing for investment advice, product advice and plan implementation. As mentioned earlier, client choice should rule providing full transparency and disclosure and fulfilment of professional and fiduciary obligations by the accountant financial adviser.

In regards to time based billing, such a remuneration practice can offer some significant disadvantages such as:

- Reward to the financial adviser for inefficiency – this is clearly not in the best interests of the client if they are paying additional fees due to the inefficiency in the provision of the work provided. This is particularly the case in financial planning advice where time taken for certain tasks (such as Statement of Advice preparation) can vary significantly between financial advisers.
- Potential discouragement of client contact – financial planning services are ideally suited to a long term and ongoing relationship due to the monitoring of implemented strategies and potential ongoing investment management. If a client feels they cannot contact the financial adviser as they will be billed, this is clearly not in the interest of either party.

- Potential inadequate client knowledge up front of the ultimate fee – whilst a quotation system may reduce this impact, unexpected complications or additional work will increase the fee which the client will not be aware of until completion and billing. This can lead to poor client satisfaction and disagreement.
- Analysis of work where limited changes are made – when creating a financial plan for a client, several strategies may be investigated before one is selected and proceeded with. It is important that the client is aware of the work undertaken and the alternative strategies considered as part of the advice, however with time based billing, the client will be charged for these investigations which they may regard as unnecessary and simply adding to the hours spent on the advice. Also, in the case of portfolio management, research and work may be done which leads to no changes being made for example on alternative products – however a client will certainly not be impressed with a bill where they see no change to the recommended outcomes.

Given these factors, time-based billing is not an appropriate charging model for financial advice. Whilst this is still a common form of fee calculation for professional services (e.g. accounting, legal services), there have been previous Government enquiries into the downside of time based billing, and it does appear that professional service firms are moving away from such a model.

An excerpt from the UNSW Law Journal (2004) UNSW Law Journal Volume 27 (1) p201) states:

"While hourly billing has the appearance of objectivity and may be beneficial in that it allows a practitioner to provide a client with an itemised statement as tangible evidence or work done, it fails to provide the client with information about the value of the service provided and obtained".
The impact of the APES 230 ED, if implemented, would be to prohibit any fee models which have asset based fees. This would effectively then leave only one permitted and appropriate fee model for financial advice – i.e. flat fees.

The draft standard therefore effectively promotes flat fees, which may be certainly be appropriate for some clients, and indeed this fee modal can have many advantages. However, this form of fee charging can provide some disadvantages, including:

- Portfolio management – where the advice relates to ongoing portfolio management, clients may be unhappy with flat fees as they may have received a reduction in capital due to market performance. In essence as a percentage, the fee applicable to the client has increased.
- Indexation of fees – unless an agreement is reached on fee indexation, the financial adviser's business may suffer as a result of stagnant revenues, which may affect the ability of the business to provide the advice that it has previously to clients (due to a reduction in profit which may affect staffing levels).
- No perceived alignment with the clients interests – much like 'success' fees, for some clients fixed fees will not be appropriate as they would like the financial adviser to be involved not only with their financial planning strategies, but also in terms of their wealth improvement, i.e. the is alignment between the increasing wealth of the client and revenue stream of the financial adviser.

- No pricing of risk – where a financial advisory business is providing portfolio management services, with a larger balance there is greater risk and potential work in terms of ongoing management, review, and portfolio construction amongst other advisory activities. A pure flat fee model may have difficulty in addressing this unless a different charging level was implemented to reflect this increased risk, thus looking more like an asset based fee model.
- Outcome alignment – ultimately financial planning services are about the achievement of the client's goals and objectives and the ongoing relationship with the client to 'get them where they want to be'. A flat fee model offers no outcome based result, only a fee mechanism based on work performed. There can be a perceived lack of association with the work performed and the result obtained.

One of the unintended consequences of a flat dollar fee regime is the perception that advice is inaccessible to all but higher net worth individuals. In reality, advisory services can be of benefit to people of all ages, however for potential younger clients, or those with limited available funds, a flat dollar fee has the implication that advice may be expensive and out of reach. Whilst this may be perception only, it has the impact of clients seeking alternative advice, such as single issue (limited) advice, or even intra-fund advice from a superannuation fund. This takes advisory clients away from the professional service that we know our accountants can provide.

In regards to asset based fees, we acknowledge that in some situations, this may not be an appropriate fee mechanism.

However, we see the advantages of allowing such a fee model as follows:

- Alignment of interest – a client may be more comfortable with a fee model that aligns their increase in wealth with their financial adviser.

- Reduced administration costs through simplified fee collection – this allows a more efficient advisory service resulting in reduced costs which can factored in the fee to the client.

- Flexibility - for different advisory services provided, a different fee mechanism may be appropriate, for example, a fixed fee for strategic work and a percentage asset based fee for portfolio management.

- Client choice - A practical difficulty of the proposals in APES 230 is where the client may request a certain fee model to be implemented. For example, a client seeking advisory services may agree with their financial adviser to a fixed fee for the initial advice, and then a percentage based fee for the ongoing portfolio management, and an hourly fee for any additional work that is undertaken. Not only is this a suitable model for both client and financial adviser, it is one that overcomes potential issues with various forms of fee charging such as expensive up front advice that may be applicable if fees were determined on an hourly rate for the up-front advice. Similarly where the advice sought is entirely strategic in nature, a fixed fee may be the agreed option for the financial adviser and client.

Whilst examining these fee models, it is also important to note that the provision of financial planning advice is generally unlike accounting based activities which are much more transaction focussed. Financial planning services are generally provided on an ongoing relationship basis that looks to meet clients' goals and objectives. This is also

important as strategies that are put in place may have a long maturity date, and require ongoing review to ensure they remain appropriate to the client's circumstances.

In allowing a variety of fee models to be implemented, choice is provided to both the providers of advice, and the client as to what is the most suitable for their circumstances.

Again we state, there is no 'one size fits all' pricing model, and consideration needs to be given to allowing flexibility in fee charging regimes for different commercial models, and different client relationships (and the type of advice that is being provided as part of that relationship).

In our view, it is not the role of APESB to be mandating this lack of choice, rather than having informed clients making informed choices?

2.6. Regulatory Developments

The Parliamentary Joint Committee on Corporations and Financial Services inquiry into financial products and services in Australia (the Ripoll Inquiry/Report) received submissions and generated debate as to the extent to which commission based remuneration conflicts advice, and whether disclosure mechanisms are sufficient to manage this conflict. Asset based fees were similarly criticised by some – particularly in relation to *"incentives on advisers to favour strategies that involve debt in gearing to build assets that generate fees for advisers".*

In response, the Government proposed in the FOFA reforms the **prospective** banning of "conflicted remuneration structures" including commissions and volume based payments between fund managers, platform providers and dealer groups. It also proposes that percentage-based fees (known as assets under management fees) may only be charged on ungeared products or investment amounts. According to the Government, these reforms will *"greatly reduce the incidence of investors being recommended financial products as a result of sales incentives offered to advisers"*.

Based on the Government response, it is apparent that fee for service structures, including asset based fees for ungeared investment strategies, are consistent with non-conflicted advice (providing the usual caveats of meeting fiduciary requirements are fulfilled – see below). The Government is also has concerns regarding the potential bans on commissions in relation to insurance, and the potential to exacerbate the very real problem of under-insurance. It continues to consult the financial services industry on this matter.

2.7. Emerging Legal Position

Legal opinion obtained by AFAC (of which Count Financial is a key member) sets out what a fiduciary duty entails and serves to highlight that:

- neither commissions nor percentage based asset fees are inconsistent with fiduciary duty, provided there is no breach of either the profit and conflict rule;
- assuming disclosure of fees and commissions, there will normally be no breach of the **profit rule or the conflict rule ("**unless the adviser actualises the conflict by advancing his own interests at the expense of the client").
- as a matter of legal principle there is no apparent justification for confining accountant based financial adviser to a fee for service definition used by APES 230 (reasons outlined in the piece);

- there is nothing in the fiduciary principle that would as general practice dictate **the removal** of conflicts of interest that may be caused by certain types of fees and remunerations.

In order to better understand the nature of fiduciary duties and how they impact with remuneration models, advice was sought to help clarify the position from a legal perspective provided by Gregory M Drew of Ninth Floor Selbourne Chambers. The key aspects of the advice and how they relate to the fiduciary duty and remunerations aspects considered under APES 230, are included below.

Financial Advisers Under a Fiduciary Duty

In most situations financial advisers, whether accountant based financial advisers or general financial advisers, will owe a fiduciary duty to act in the best interests of their client for the 'purposes of and within the scope of the retainer.[4]' The duty to act in the best interest in this sense does not create a positive duty to act in the client's best interest but rather requires that the adviser must not obtain an unauthorised profit from the client and not be in a position of conflict. This is known as the profit rule and the conflict rule.[5]

The characteristics which give rise to fiduciary obligations owed by accountant based financial advisers to clients include the inequality of the relationship between the financial adviser and the client in terms of expertise and specialised knowledge the financial adviser has over the client; the control over the information to the client; the ability to significantly influence the client's decisions and the dependence of vulnerability of the client in reliance of the financial adviser.[6]

Where a fiduciary duty exists this requires the financial adviser to take care not to breach the profit rule or the conflict rule and where there is a breach the financial adviser must then account for any profits or compensate for any losses arising from the breach. [7]

Fiduciary Duty and Remuneration Models

There is nothing in fiduciary principles to prohibit percentage based asset fees or commissions from being paid to financial advisers unless there is a breach of the profit rule or conflict rule.[8] This means that remuneration or fee structures such as commissions or percentage based asset fees are by their nature not inconsistent with fiduciary duties in and of themselves.

This is an important point to highlight as the ED proposes to prohibit both percentage based asset fees and commissions (including insurance) as being inconsistent with fiduciary duties which is somewhat of a misunderstanding.

Remuneration structures are inherently conflicted in and of themselves creating tension between the self-interest of the financial adviser generating a fee and the interest of the client in paying a fee for that service.

[4] Page 1, Memorandum of Advice (2010) Gregory Drew, Appendix 3
[5] Page 1 & 2, Memorandum of Advice (2010) Gregory Drew, Appendix 3
[6] Page 4, Memorandum of Advice (2010) Gregory Drew, Appendix 3
[7] Memorandum of Advice (2010) Gregory Drew, Appendix 3
[8] Page 1 & 2, Memorandum of Advice (2010) Gregory Drew.

Conflicts can be managed through full disclosure of commissions and fees to the client. Where there is full disclosure of fees and commissions by the client, there can also be no breach of either the profit rule **unless** the adviser **'actualises** the conflict by advancing their own interests at the expense of the client.'[9] The key point in this regard is not the mere existence of a conflict but that the adviser has acted on the conflict and furthered their **own interests 'at the expense of the client.**' The trigger point, for actual breach of fiduciary duty, is acting on the conflict to place the adviser's interests ahead of the clients.

Where this relates to commissions or generation of fees, simply placing a client into a product which pays the highest commission or generating a strategy which pays the highest fees does not necessarily breach the conflict rule or the profit rule. There may be legitimate reasons for placing a client in such a product or developing such a strategy.[10] The key point in this regard is advancing the client's interest first and ahead of the self-interests of the financial adviser.

No Legal Basis for Ban

There is also no apparent justification from a legal perspective for limiting or restricting remuneration to the fee for service definition included in APES 230[11] there is nothing within fiduciary duty which would require the removal of conflicts of interest that may be caused by certain remuneration structures or fees[12], such as percentage based asset fees or commissions.

A fundamental issue with the ED is the belief that it is necessary to **remove** conflicts of interest rather than to identify and **manage** any potential conflicts of interest. Conflicts of interest can be appropriately managed. The key issue is ensuring that accountant based financial advisers understand their ethical and professional duties to manage conflict of interest and not to misuse their position for personal advantage.

This is an achievable measure, whereas removing conflicts of interest as a matter of principle may prove difficult, if not impossible, bearing in mind that conflicts are inherent in any charging model. For example, the tension between advancing a financial advisers own interests that pay higher fees at hourly based rates and advancing the client's interests by recommending an appropriate strategy or suitable products in the shortest time possible may not always be the most profitable in terms of the fees generated.[13]

We understand and appreciate the Exposure Drafts' intent is to hold accountant financial advisers to a higher standard of conduct in relation to fees and commissions than is required by general law, or will be required by the FOFA changes (effective July 2012). According to the ED authors, this is to *"create relationships of trust with their clients, which is a central feature of any professional relationship"*. The nature of professional obligations – especially objectivity and integrity – are however already proscribed elsewhere in the accounting professional standards (especially APS 12) covering many of the objectives which APES 230 aims to cover.

[9] Page 5 Memorandum of Advice (2010) Gregory Drew.

[10] Page 5 & 6 Memorandum of Advice (2010) Gregory Drew.
[11] Page 9 Memorandum of Advice (2010) Gregory Drew.
[12] Page 8 Memorandum of Advice (2010) Gregory Drew.
[13] Page 5, Memorandum of Advice (2010) Gregory Drew.

Rather than risk duplication and watering down of the existing APS 12 standard, it is suggested that APES 230 be reviewed in light of the fact that the objectives and standards imbedded in the ED exist within other accounting professional standards and will be further defined and governed through the FOFA reform process including fiduciary obligations and the prohibitions on investment commissions and asset based fees on any geared product or investment amount.

2.8 APES 230 Disruption to Industry and Unworkable Elements

In terms of the proposals in the ED, consideration needs to be given to the practical implementation of these measures in light of the current operation of other parts of the financial services industry. For example, the insurance industry at present operates predominantly on a commission basis, which has been built into product design and manufacture. To impose a standard on a section of the advice industry may be difficult to implement purely in terms of the current product availability.

However, one of the larger issues is the consequences of this action and what the consequences will be. Implementation of APES 230 would have the impact of completely changing the way insurance advice is provided. This is something the Government is widely consulting on to understand and minimise any unintended consequences as an extension to the FOFA reforms. For example, from a product manufacturer perspective would the insurance product provider simply cease any commission and retain the amount? Would there be a separate class of product for these financial advisers? How would such an amount be rebated to the client if this was required?

Prior to implementation of the current form of APES 230, significant investigation would have to be undertaken into the impacts on these changes not only on the providers of financial advice, but also the public. This is at the heart of the debate on the public good – we know that there exists issues such as the underinsurance problem in Australia, however what investigation has been made into these impacts as a result of these changes. Would the provision on insurance advice decrease? Certainly 77% of our survey respondents believe this is the case. It would appear this is directly in contradiction with the aims of the APESB and this standard.

Not only is insurance a significant issue here, but also other investments and lending products. The Government has a taken a sensible position here in proposing the implementation of the FOFA reforms as a prospective measure rather than a retrospective one and is also undertaking significant consultation on issues such as insurance. Not only does this give advice firms time to adjust their business if required, but also allows product providers to meet the demands of this changing fee landscape so that all will be ready by 1 July 2012.

With lending products, to impose the recommendations in the ED would potentially reduce the independence of advice in this area. The ED assumes that commissions for lending products could simply be removed and reflected in product pricing. We are of the view that this simply will not occur, as the lending products sold through intermediaries such as brokers would be cheaper than those sold through the banks internal network. Obviously the banks would not allow this price differentiation to occur and they would need to equalise their loan product pricing. This would subsequently flow through to the broker channel and make these products comparatively more expensive after fees were charge (to cover the advice cost). This would reflect in poorer loan choice in terms of advice for consumers.

3. DETAILED COMMENTS

3.1. Fiduciary Duty

From a legal perspective most retail client situations will give rise to a fiduciary duty between the financial adviser and the client.[14] Count also agrees that financial advisers are under a fiduciary obligation when dealing with their clients and understands the government proposes to formally introduce this obligation as part of its Future of Financial Advice (FOFA) reforms.

The following characteristics highlight the fiduciary nature of the relationship and thus the fiduciary obligations that are imposed upon an accountant when providing a Financial Advisory Service to a client.

1. The inequality of the relationship in terms of professional knowledge, skill and experience.
2. The control of the professional information and advice provided to the client.
3. The ability and opportunity to significantly influence the client as a result of the position set out in (1) and (2) above.

The dependence and vulnerability of the client in reliance upon the accountant/financial advisor.

Given all that is set out above, the law requires that the financial adviser must act in the best interests of their client for the purposes of the relationship. Best interests in this sense does not create any positive obligating to act in the client's best interest but requires that the accountant must not obtain any unauthorised benefit from, and not be in a position of conflict as a result of the professional relationship with the client.[15] This is known as the profit rule and the conflict rule and is central to the fiduciary obligation owed to the client and enforceable in a Court of Equity.

Central to the proposed standard is the clear statement that the accountant who provides a Financial Advisory Service to his/her client is under a fiduciary duty to the client and is subject to the profit and conflict rules. Reflecting on recent proposed reforms within the Financial Services Industry arising from the Ripoll Report (Ripoll) with regard to forms of remuneration to financial planners, APESB has sought to address this area for accountants by proposing the following:-

'Fee for service means fees determined by taking into consideration factors such as the complexity of the Financial Advisory Service, the required skills and knowledge, the level of training and experience of the Member and the Member's staff, the degree of responsibility applicable to the work such as risk and the time spent on the Financial Advisory Service.

[14] There is no single determinative factor which gives rise to a fiduciary duty. The existence of a number of characteristics will normally give rise to fiduciary duty. See Pages 3-5 of the Memorandum of Advice for a detailed analysis.

[15] Page 2 Memorandum of Advice (2010) Gregory Drew.

Fee for service does not include Commissions, percentage based asset fees, production bonuses or other forms of fees or <u>remuneration that are calculated by reference to product sales or the accumulation of funds under management</u>, (emphasis added) whether paid by the Client or a third party such as a product manufacturer.'

It is clear that fees calculated as against that underlined in the 2nd paragraph above are disallowed by APESB on the basis that such remuneration is inconsistent with the fiduciary obligations and duties imposed upon an accountant in the relationship with the client by APESB. The inference being that in such circumstances there is a clear breach of the profit and conflict rules in that the remuneration received and calculated by reference to either product sales or asset based percentages may not have had any bearing on the actual professional work carried out, and that the payment of remuneration where there is not a direct link, or proportionality to the professional work carried out, puts the accountant into a conflict position with regard to the bests interests of the client.

Fiduciary Duties and Remuneration Models

However, from a fiduciary duty perspective there is nothing to prohibit percentage based asset fees or commissions from being paid to financial advisers unless there is a breach of the profit rule or conflict rule.[16] Further, there will normally be no breach of either the profit rule or the conflict rule provided that adequate disclosure of fees and commissions have been provided to the client.[17]

The key principle in the fiduciary remuneration question is whether the profit and conflict rules have been breached. In short, whether the fiduciary has been improperly remunerated (usually being overpaid compared to the actual degree of work carried out) and that the fiduciary's obligations to put the clients' interests before his/her own has been conflicted in that the fiduciary has profited at the expense of the client.

Where a fee characterised as a percentage of a portfolio's sum, such as a percentage based asset fee, but nevertheless arrived at by reference to factors such as complexity, degree of difficulty, professional knowledge, skill and expertise, responsibility, risk, time and resources, is fully disclosed to the client, as well as accepted by the client there **can be no breach of the profit and conflict rules**.

Also, in such circumstances should the client authorise a third party to make the disclosed and agreed to payment to the fiduciary, there can be no breach of the fiduciary obligation and duty to the client in this regard.

Where fees are calculated by reference to accumulation of funds under management, and such fees are acknowledged and assented to by the client, there would be **no conflict**, but a clear alignment of both the professional and the clients' interests in that the adviser and the client are both focused on the portfolio performance remaining positive for the client. Asset based fees are neutral to the duties owed under a fiduciary duty and do not in and of themselves create a conflict.

[16] Page 1 & 2, Memorandum of Advice (2010) Gregory Drew, Appendix 3
[17] Page 5 Memorandum of Advice (2010) Gregory Drew Appendix 3

Point of Difference between Commissions and Asset Based Fees

Neither asset based fees nor commissions are inconsistent with, or by their nature prohibited by, fiduciary duties. There is however a fundamental distinction between the two which warrants further clarification.

Asset based fees are paid by the client whereas commissions are paid by the product provider.

For example, where a client chooses to pay for the advice through asset based fees, the client agrees to pay the financial adviser a percentage of their portfolio and the payment will be made either by the client or directed to be paid from the client's investment. In each example the payment is agreed to by the client and is made from the client's money. Common practice with this kind of payment frequently involves capping fees altogether or scaling fees at certain thresholds thereby reducing the percentage based fee as the investment increases. What is important here is that the client agrees to the payment, it is disclosed and the payment is made by the client.

Commissions however are different. It is the product provider which pays the financial adviser for the investment made into a particular product.

Conflicts of Interest and Remuneration Structures

The prohibition of various remuneration structures is founded upon the prohibition against conflicts of interest. As noted earlier, all remuneration models are by their nature imbedded by conflicts including hourly based fees.

Commissions

The insurance industry aside, (this issue has imbedded complexities such as underinsurance which remain unresolved and will need to be considered) we concede the move away from commissions recognising the conflict where payment is made by a product provider and not by the client. The industry recognises the potential for conflict and is now moving away from commissions. Under the government's proposed FOFA changes it is likely that a ban on commissions will come into effect from 1 July 2012. Many businesses and dealer groups across the industry have in fact already moved away from commissions to a fee for service regime.

Asset Based Fees

With respect to percentage based asset fees, we have also highlighted the important distinction from commissions, which is the source of the payment which in this case is made by the client and not the product provider.

Where the concern with asset based fees relates to concern that there will be an inappropriate inflation of assets under management in order to increase revenue, which is inconsistent with the client's personal objectives thus giving rise to conflicts of interest, the government has moved to address those concerns by prohibiting asset based fees related to gearing. We believe this adequately manages that conflict. What is of key importance in this regard is managing conflicts and understanding fiduciary obligations owed by accountants who provide financial advice.

The bottom line is not the remuneration methodology which gives rise to a conflict or breach of fiduciary duty. It is the manner of the fee calculation and that the fee is calculated honestly and accurately referenced against the work actually carried out and that full disclosure to, and agreement from, the client has been obtained and that any conflict in this regard is avoided.

If the nature of this proposal is to regulate against inappropriate advisory practice, there are proposals already in place to cater for these circumstances. This includes the Government proposal regarding 'opt in' arrangements, where the client will have to positively engage the financial planner on a regular basis.

We would recommend that defining a fiduciary duty ahead of proposed Government reforms is unwise and premature. An unintended consequence of the proposal may be that a different requirement is legislated by the Government, requiring either an amendment to APES 230, or accountants providing financial advisory services operating in a different competitive environment.

An alternative to this proposal is to introduce a positive obligation regarding the nature of the advice provided. This is a reasonable proposal in our view and caters for the client's circumstances.

3.2. Imposition of prescribed fee models

One of the issues with APES 230 is the imposition of dictated or prescribed charging models on accountant based financial advisers by their professional body with little corresponding benefit to clients or the public at large.

APES 230 seeks to restrict accountant financial advisers to 'traditional' fee based models to a subsector of the accounting profession only, namely accountant based financial advisers. This is inequitable when compared with the rest of the accounting profession (does APESB intend to extend this standard to Corporate Advisory work done by leading Big 4 and Mid-Tier accounting firms, where the most significant basis of remuneration are success fees, namely percentage of transaction value?) and for the reasons outlined in this submission we would assert it is also unnecessary.

As outlined in section 2 of this paper, there are a wide variety of relationships, advisory services and arrangements established between advisers and clients which need to be accounted for and reflected in the availability of choice around remuneration arrangements.

APES 230 seeks to restrict accountant financial advisers to 'traditional' fee based models – this is anachronistic and limits members and the professions. What relevance does a fee model based on time spent (input model) have to the value delivered for the client (output orientated?). Would the APESB then extend this standard to Corporate Advisory work done by leading Big 4 and Mid-Tier accounting firms, where the most significant basis of remuneration are success fees (percentage of transaction value)?

Furthermore, the issue of competitive disadvantage from non-accounting financial advisers against the rest of the industry is a very real and important consideration.

We are of the view that customers should be given a choice as to whether a fee for service remuneration model or some other remuneration model is used provided that the remuneration model is consistent with current legislation and does not breach fiduciary duties (as recognised by a court of equity and soon to be imbedded in regulation). The mandatory requirements of APES 230 in relation to a fee for service model reduce customer choice with little or no corresponding benefit.

A possible solution may be to require members to offer a fee for service model to customers as one option and then allow customers the choice as to whether they would like a fee for service or another remuneration model to be used.

To the extent that the APESB is concerned about certain remuneration practices, we would assert that the government has recognised key areas of concern and is proposing to address these areas by prohibiting investment commissions and percentage based asset fees on any geared product or gearing amount, which we believe are sufficient to address remuneration concerns.

We recommend that rather than prescribing fee models as a means of quality advice control, an alternative is implemented to demonstrate the appropriateness and quality of the advice.

3.3. Limited advice

It is likely under the current Government reforms and proposals that the provision of limited advice will increase as the Government seeks to allow for the provision of advice for clients who may not be able to afford a holistic service. Of concern in the proposed standard is paragraph 7.1 which seeks to propose the research of alternative strategies and courses of action that can reasonably be expected to meet the client's financial needs. This will certainly be required for some advice work, but not all.

We would recommend that clarification be provided so that scoped or limited advice is allowed for without the requirements that may exist for comprehensive or holistic advice. We recommend clarity be provided within APES 230 to cater for limited advice circumstances.

3.4. Legislative Alignment

As you are aware, the Government has a reform agenda established through the Future of Financial Advice proposals. Has the APESB considered this proposal in light of this and also reforms considered as part of the Cooper Review?

We believe that it is premature to implement APES 230 in a scenario where the Government has not yet released legislation which will most likely overlap with the issues dealt with in APES 230. It would be better to understand the Government's changes and allow for consistency between new changes and what is proposed under APES 230.

Operative Date
It is proposed that APES 230 will be operative from 1 July 2011. Some of the requirements, particularly the move to a fee for service model as set out in APES 230 constitute major changes to the businesses of financial advisers at a time when the Government also plans to release legislation in relation to its Future of Financial Advice reforms.

We note the following comment in a Media Statement issued by the Joint Accounting Bodies (JAB):
'In this case, less than 12 months would not provide JAB members with sufficient time to transition to the new standard, while also taking into account the federal government's Future of Financial Advice reforms.'

We recommend that to avoid any unintended consequences regarding the timing of these proposals, that they be aligned with the Government's Future of Financial Advice reforms.

3.5. Competitive disadvantage

For a professional body to expect more from its members than the Federal Government expects of non-members, or to place them at a commercial disadvantage as compared to non-association members, could give rise to resentment in the membership affected and be interpreted by those affected members as prejudicial to their professional practice. To impose under the banner of professional ethics and standards, a regime that not only demands of its members practice standards in excess of what the Federal Government requires of others practicing in the same field, could have the effect of being anti-competitive and commercially damaging.
Also, this could potentially create uncertainty and confusion for clients who seek advice as different financial advisers will have different prescribed (not by choice) fee models under which they operate.

The impact of the proposed standard will disadvantage smaller to medium size accounting firms rather than larger professional based accounting firms given the distinctions in revenue streams. Smaller to medium sized accounting firms may be reliant on income generated through financial advice as a necessary part of their income whereas larger professional firms may not (their income tends to be well diversified across other business areas such as liquidations/mergers and acquisitions etc). It is likely that the ramifications of the proposed charging models will disadvantage the smaller based accounting firms over the larger practices. Any standard proposed needs to ensure equity of application amongst the members.

We recommend a level playing field be provided across the financial advice landscape to ensure that consumers are not confused or disadvantaged by different fee mechanisms in the same profession.

3.6. Clarification of definitions

The definition of "Commission" is so broad that it captures almost all payments to financial advisers (including payments from financial services licensees to their financial advisers). We note also that a payment from a client to a financial adviser appears to be included in the definition of a commission.

In our view, "Commission" should be defined as amounts paid by product providers to financial advisers (or their AFS licensee) out of their own resources (i.e. not out of client funds) for putting clients into (or for keeping them in) their product (i.e. for services provided by the planner to the product provider – not for services provided by the financial adviser to the client).

There should also be consistency with the legislation on the definition of commission and what is prohibited e.g. if platform payments are not prohibited on the basis that they recognise the work undertaken by financial advisers and do not cause a conflict (and may just lead to other adverse change such as financial advisers becoming product providers), they should also not be prohibited by APES 230 as it will place accountant financial advisers at a competitive disadvantage with no real benefit to clients.

APES 230 also appears to be aimed at prohibiting the receipt of insurance commission – this will have the effect of increasing the cost of insurance advice and so will likely lead to a reduction in the amount of insurance recommended to and taken out by clients. If commission is not prohibited by law on insurance products and if all insurance products on the Approved Product List pay commission at the same rate, APES 230 will only disadvantage clients and accountant financial advisers. This will only serve to exacerbate the widespread under-insurance problem.

The definition of Fee for Service is also not clear. It is also not clear whether accountant financial advisers can continue to receive retrospective commission as the prohibition is only on "charging" clients a particular way (the adviser does not charge "commission" in the true meaning of that term – it is paid by product providers to financial advisers or their AFS licensee).

The Government has not proclaimed any changes to the receipt of commissions for life insurance products due to the enormous implications this has for the insurance industry and the community at large. Such as a proposal needs careful consideration and research, to ensure that Australia's current underinsurance problem is not exacerbated.

We acknowledge and agree on changes to the financial advice industry regarding the receipt of commissions. We propose that any fee arrangement suitable for the client's circumstances be discussed and agreed with the client prior to the implementation of any advice, and disclosed to the client in writing.

3.7. Retrospectivity

APES 230 seeks to impose retrospective application in relation to the receipt of certain income prior to the commencement of the standard. An accountant financial adviser may have charged a lower fee to clients for advice or services on the basis that the financial adviser will continue to receive trail commission for a period and so the planner will be unfairly disadvantaged as a result of APES 230. The perceived conflict APES 230 is aimed at has also already occurred in that the product has already been recommended. We note that commission is not a cost to the client – only the product provider, and that commission is not paid for services provided by the financial adviser to the client. The conflict of keeping a client in a product due to trail commission receipts can be better addressed through other methods (e.g. mandated disclosure of commission and offer of review on a regular basis).

The retrospective nature of these proposals represents a substantial issue both in terms of implementation, but also in the impact on existing business structures. Has thought been given to the implications of this recommendation even in terms of the provision of advice documents? Will additional documentation need to be provided and agreed with clients regarding existing income received from such sources as life insurance commissions? How does the APESB propose businesses deal with this issue for thousands of clients?

This would surely represent an unacceptable outcome to a substantial number of financial advisory practices and would impose an enormous administrative/ cost burden, not to mention the possible restructure of how the business operates. We do not believe this can be done nor is it a practical option for advice providers.

There is also the issue of existing contractual arrangements being in place with clients that are impacted by these changes. This is not something that can simply be altered by a change in policy – this represents a significant legal risk that would need to be investigated and determined prior to changes being made - hence our recommendation for prospectivity and not retrospectivity.

A practical example of the difficulties associated with this is in relation to a potential rebate of commissions received assuming these cannot be refunded by the provider. Is an adviser to refund a minimal amount received via commission back to the client? Would this depend on the materiality of the amount? The administrative burden would simply make this impossible to comply with and we believe would not be in the public interest.

As mentioned previously, to pre-empt this timing of the Government reforms seems unreasonable, and also proposes significant structural implementation issues. To place advisers in a position where their obligations are so significantly different legislatively as opposed to the standard creates confusion and potential non-compliance.

The Government has put in place measures through the FOFA reforms from 1 July 2012. We recommend this time line be implemented as part of APES 230, along with the change to making these changes prospective only.

We do not believe that this proposal acts in the best interests of consumers or the industry. Existing products may not even be capable of this provision, placing the accountant who has provided financial advisory services the clients in good faith in a very difficult position. This may require a complete re-engineering of the business model, and substantial further advice documentation to be provided to clients – who would be unwilling to pay for such further disclosure.

We recommend that the retrospective nature of the proposal be removed and aligned with the Government's Future of Financial Advice reforms.

3.8. Application of standard

We recommend that there be clarity in regards to which members APES 230 will apply. For instance, we believe it should be made clear that the standard will not apply to financial advisers who run their financial planning business separately from their accounting business. The APESB should not have jurisdiction to determine the standards that apply to businesses run by members that are not accounting businesses.

It should also be noted that Financial Advisory Services tends to be offered by accountants to their clients through a number of structures. The most common appear to be the following:-

1. An independent Financial Services company is incorporated with the accountant/practice and a financial adviser as directors/shareholders. The financial planner or the company is an authorised representative of a licensee and receives payment from the fund manager/s and a fee/dividend or profit is then passed on to the accountant/practice.

2. The accounting practice incorporates an independent Financial Services Company. The company holds a corporate authorisation from a licensee and the independent company provides Financial Advisory Services to clients of the accounting practice. Remuneration is received by the corporate authorised independent company and the income arising there from is distributed in an agreed manner.

3. The accountant is an authorised representative of a licensee and provides the Financial Advisory Services personally. The accountant receives payment directly from the licensee.

4. The accountant holds a Financial Services Licence and provides the Financial Advisory Services. The Fund Manager pays commission directly to the accountant.

In (1) and (2) above it may be the case that remuneration received by the accountant/practice would not be in breach of the draft proposition. Example 3. could offend in this regard. Example 4. would offend against the draft principle.

The inequitable impact on small versus larger accounting firms also needs to addressed. We believe it is not the intent of the APESB to remove client choice of payment method nor impose upon product providers unnecessary burden when engaging with accountant financial advisers with regards to both new and existing clients.

An example is an accountant operating in a business of financial advisers, who is now under different obligations than their colleagues. An unintended consequence may be structural engineering of advice practices to avoid these requirements.

4. MEMBER VIEWS – Synopsis of Survey Results

The full survey results of the AFAC survey are provided in Appendix 1. These comprise of 272 responses from accountant financial planners across the AFAC dealer groups.

Some interesting highlights are:

- Polarised results on whether APES 230 goes beyond what is required under fiduciary duty (roughly equal agreement and disagreement)
- 76% agreement that APESB should wait for Government for greater clarification on fiduciary duty under the FOFA reforms
- 83% disagreement that it is the domain of professional bodies to prescribe fee charging models
- 76% disagreement that it is appropriate for APES 230 to be more prescriptive than the Government regulations

- 87% disagreement on the APES 230 timetable, with more than half in strong disagreement
- 85% agreement that accounts engaged in financial advice will be disadvantage as compared to non-accountant financial planners
- 78% disagreement in banning asset based fees, with more than half in strong disagreement
- 77% in agreement that the provision of insurance advice will reduce
- 90% in disagreement with the retrospective nature of the proposals
- 55% indicating that they would reconsider their membership of their accounting body if the proposals were implemented (although this reaction needs to be tempered by the likelihood that if one is operating within a public accounting practice, the standards are likely still applicable under current professional body by-laws)

5. CONCLUSION

Whilst APES 230 is well intentioned, we submit that it is premature, potentially superfluous to existing standards and emerging regulation, potentially in conflict with some key emerging regulatory precepts, and overly orientated to rules-based prescription rather than a principles based approach.

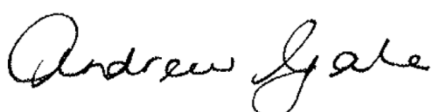
APES 230 is based on a questionable premise regarding the interaction of fiduciary duty and the management of conflicts, and their intersection with various remuneration models. We have submitted an extensive legal opinion in support of this contention.

The proposed implementation timetable for APES 230 is out of line with the Future of Financial Advice reforms. Implementation would also have serious industry distorting impacts for dubious benefits, and arguably be inconsistent with the public interest mandate for the APESB.

We submit that a re-drafted version of APES 230 be considered after the exact form of the FOFA reforms becomes known, which is schedule to occur within 6-12 months. If a redrafted form of APES 230 is to be considered, we urge the APESB to ensure that is a principles-based standard rather than a rules-based prescriptive model.

We would go further and submit that APES 230 in its current form should be abandoned. The interaction of other accounting professional standards, such as APS 12 and APES 320, combined with the FOFA reforms will provide strong and appropriate guidance to professional conduct in the provision of financial advice.

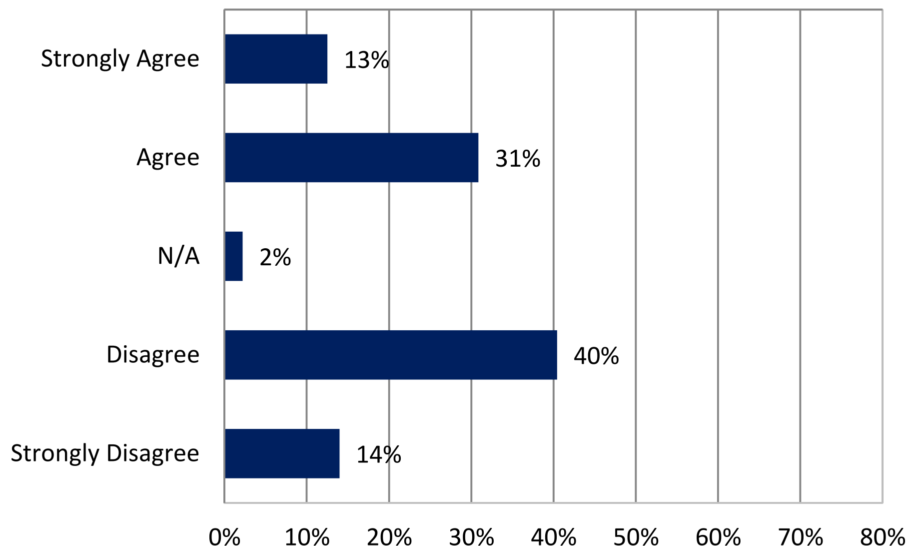
Count, through the Accountants Financial Adviser Coalition (AFAC) is very willing to work with the APESB and the working groups involved in standards development to ensure a constructive and workable professional standard for Financial Advice should the APESB resolve that it still wants to proceed with a Financial Advice Standard.



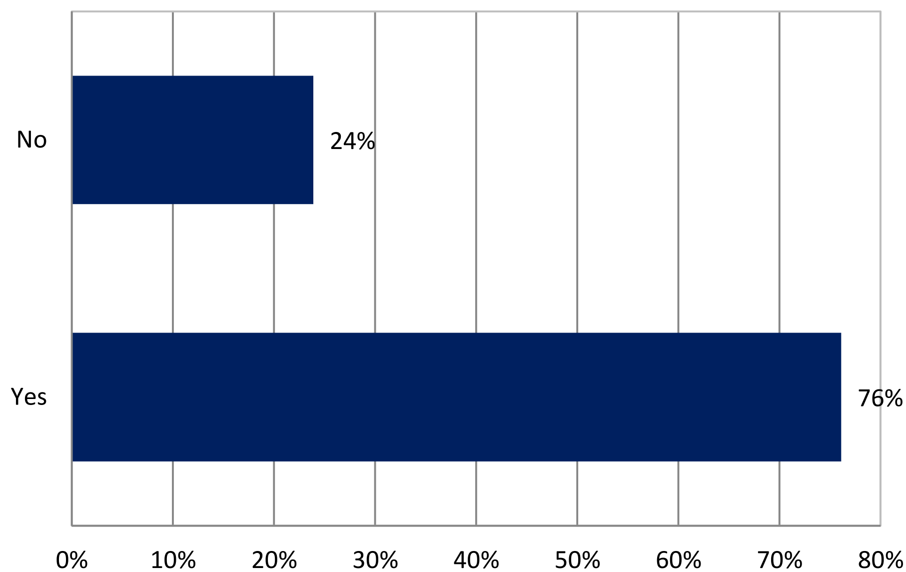
Andrew Gale
Chairman & Convenor
Accountant Financial Adviser Coalition

Appendix 1 – Survey Results

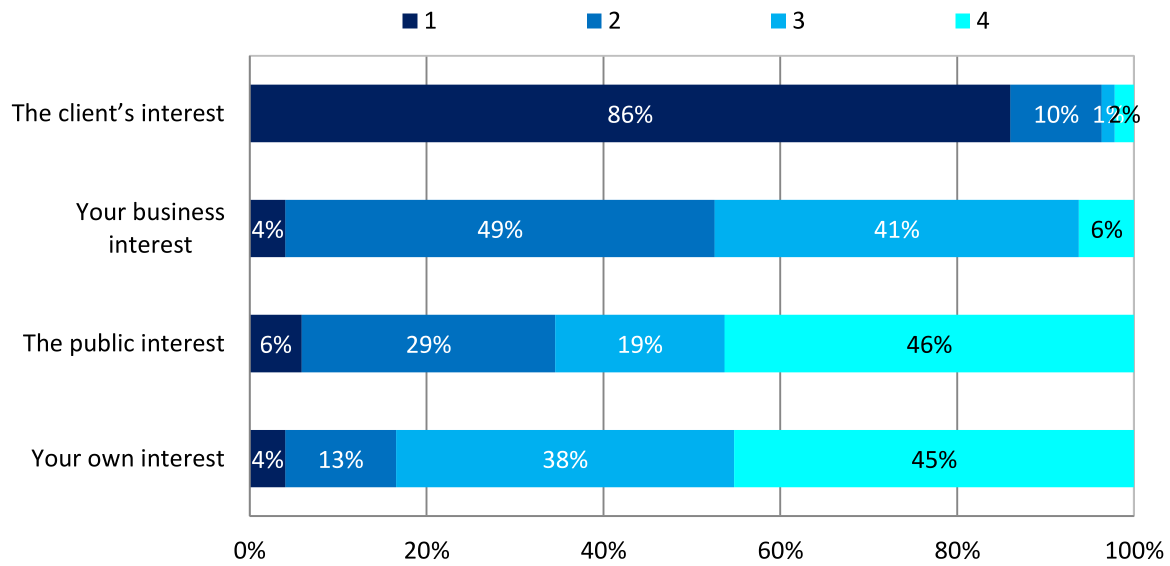
1. Do you believe this goes beyond what is required under the concept of 'fiduciary obligation'?



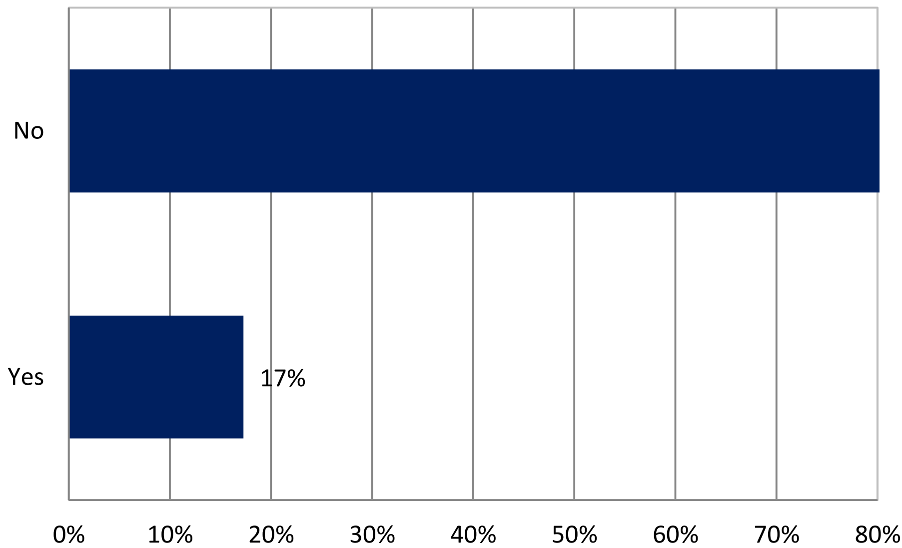
2. Do you believe that the APESB should wait until the Government releases further information and/or a definition of what is required under a 'fiduciary relationship'?



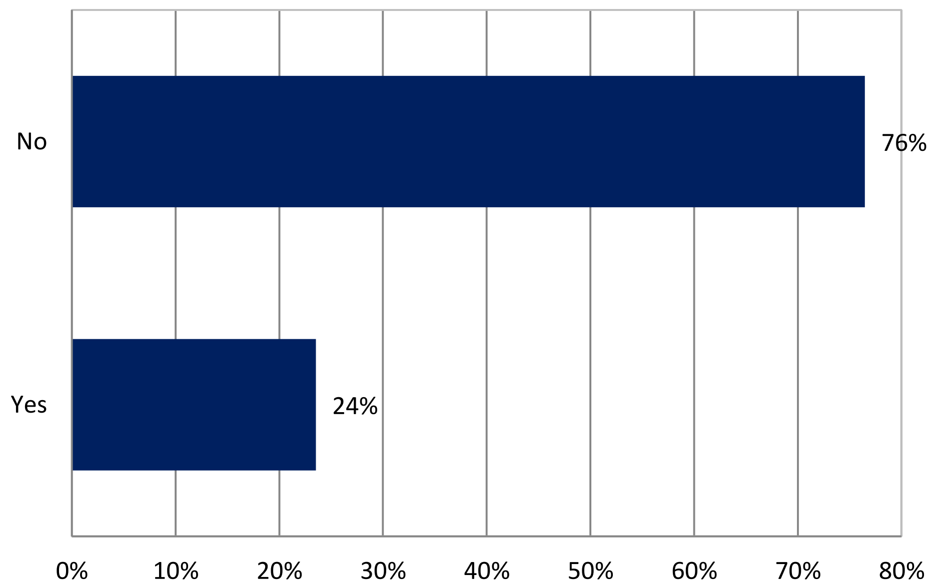
3. Please rate these in order of importance (with 1 being most important, 4 being least important) from your perspective as your role as accountant:



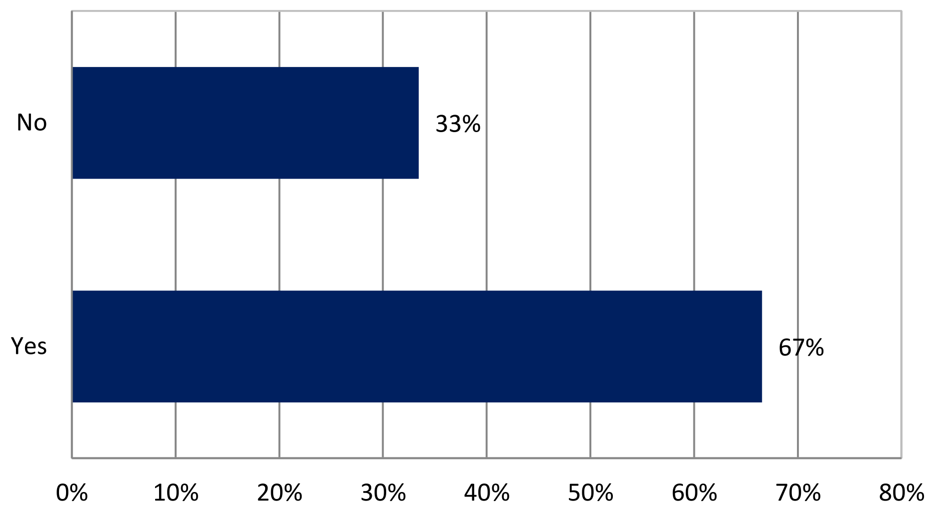
4. Do you believe that it is the domain of a professional body to prescribe fee charging models?



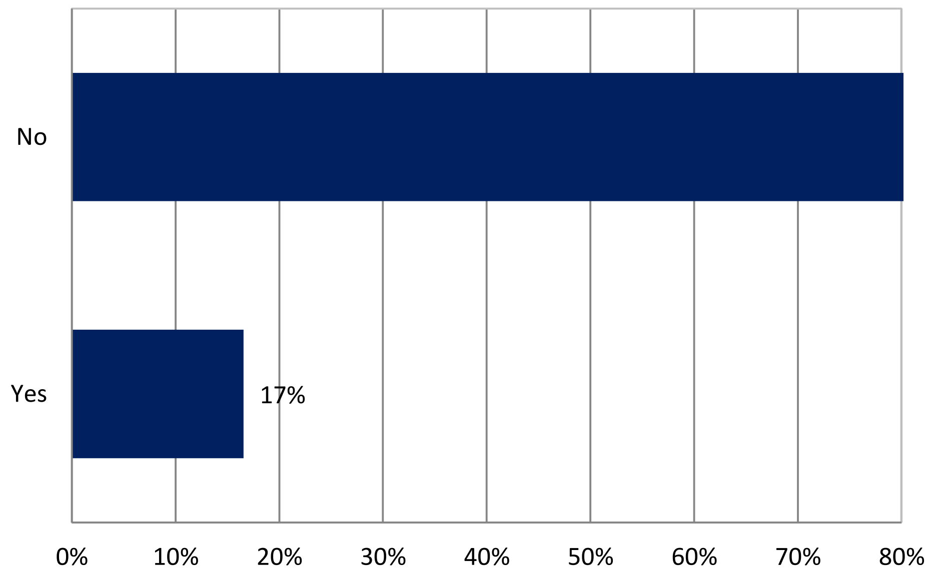
5. Do you believe it is appropriate for this proposed standard to be more prescriptive than the regulations?



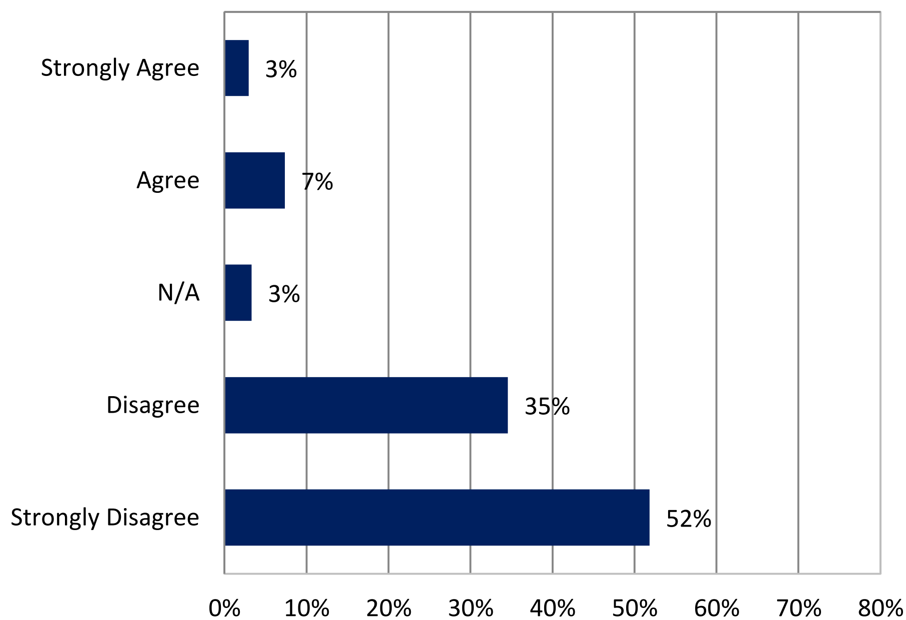
6. Do you see an increased demand in your planning business for limited advice?



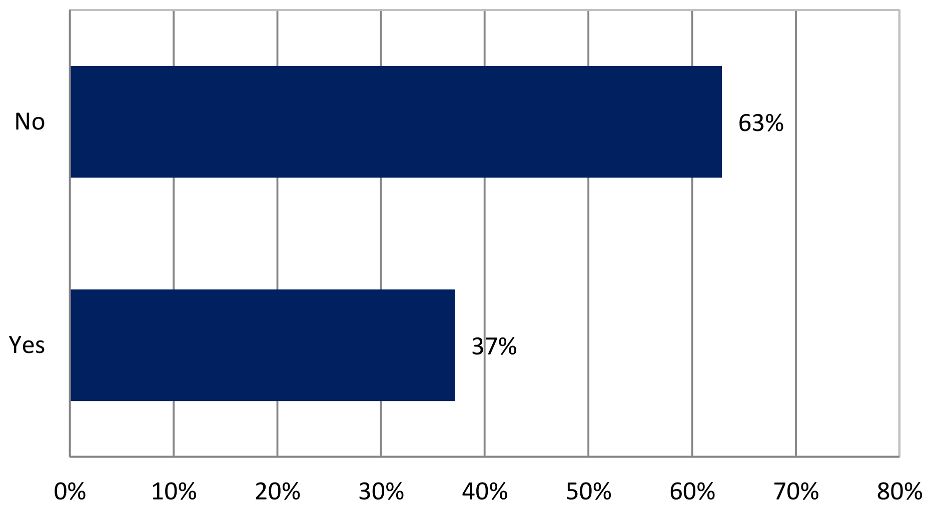
7. One of the requirements of APES 230 is to research and present alternative strategies for clients. Do you believe this is appropriate for limited advice situations?



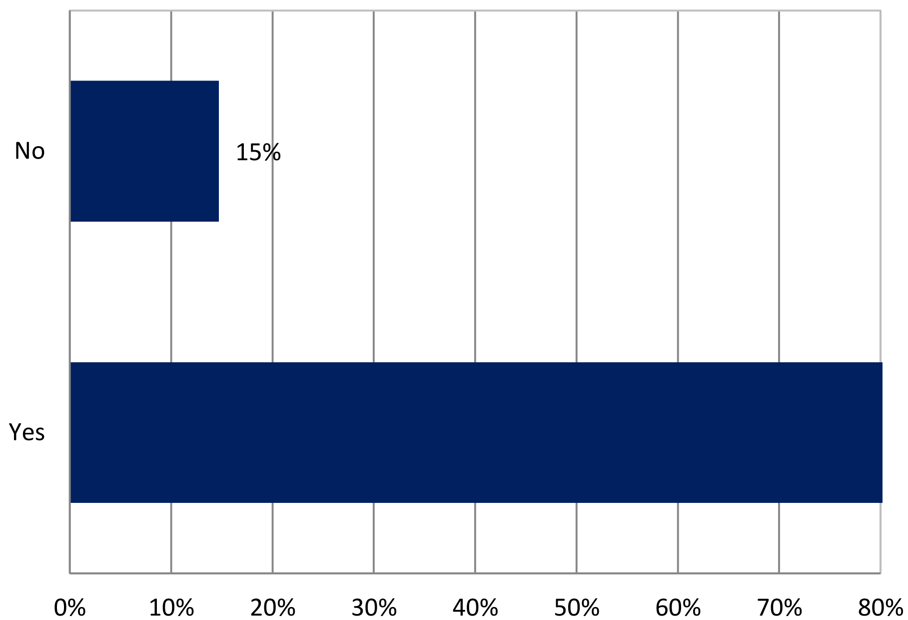
8. Do you agree with the timetable set for these proposals in light of the difference in timing between these proposals and the Government's Future of Financial Advice Reforms?



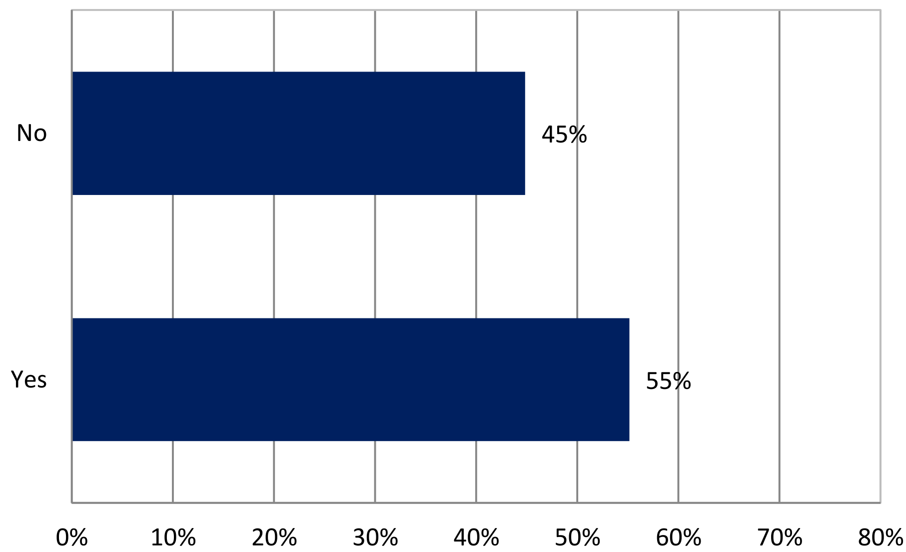
9. If the commencement date of 1 July 2011 is adhered to, will your business be ready?



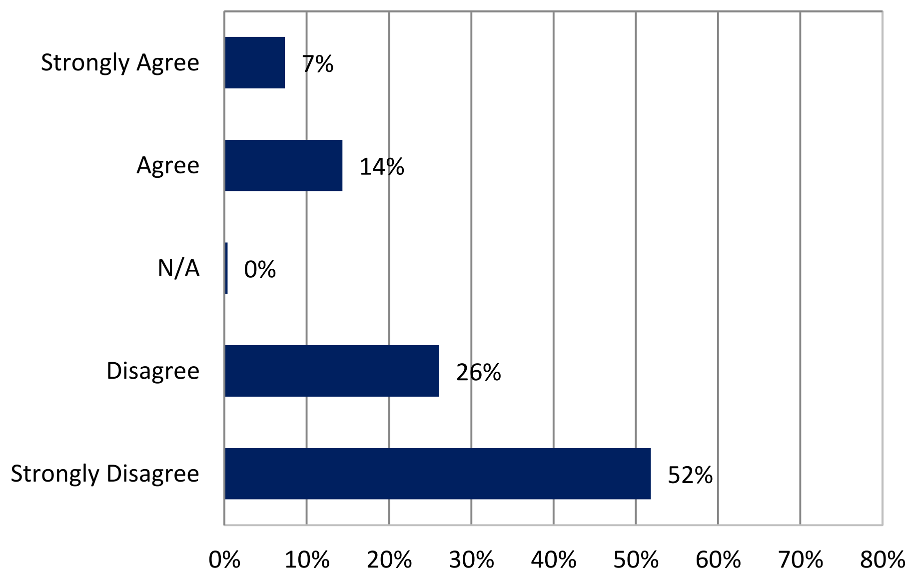
10. As an accountant engaged in financial advice, do you believe you will be disadvantaged by these proposals as they will not be applied to non-accountant financial advisers?



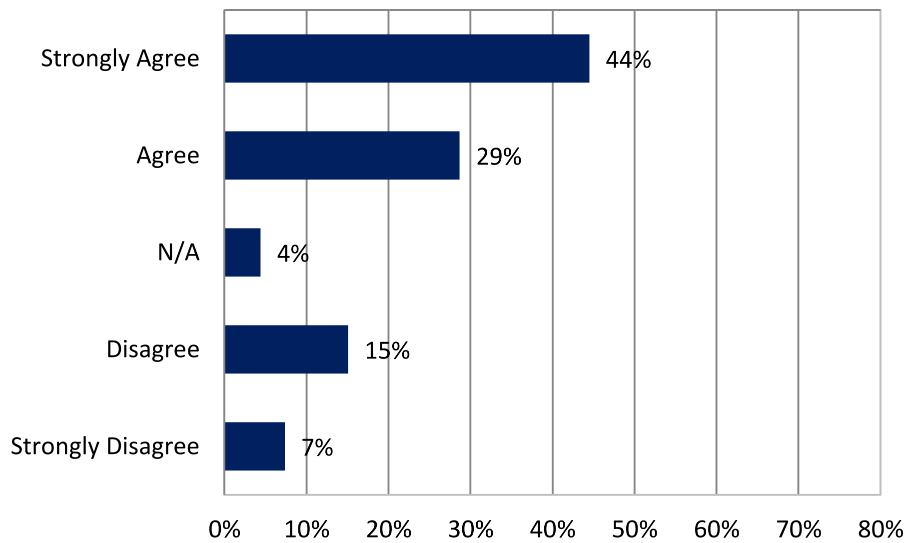
11. Would you reconsider your membership of your accounting body if these proposals are implemented?



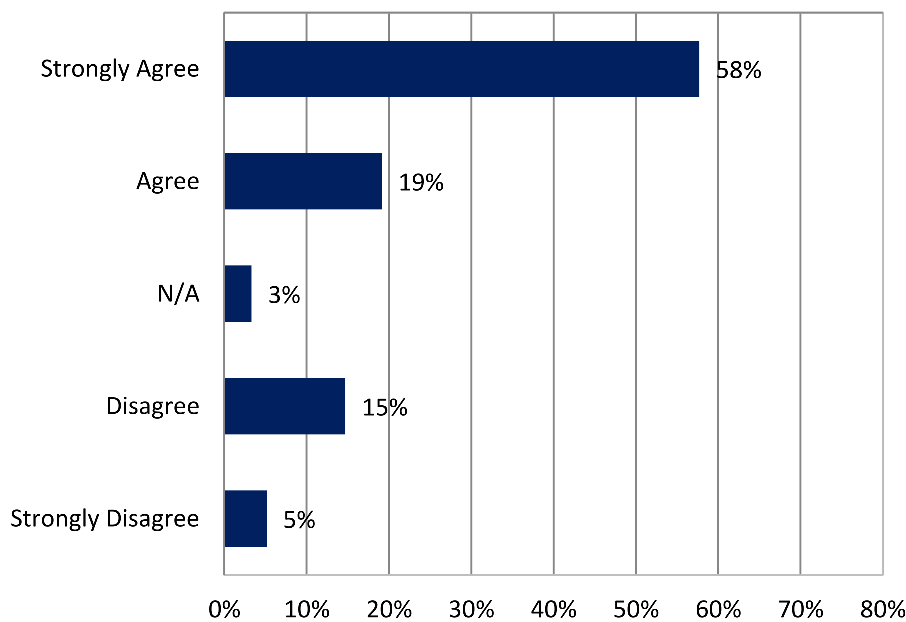
12. APES 230 proposes that the definition of fee for service does not include percentage based asset fees. Do you agree with this proposal?



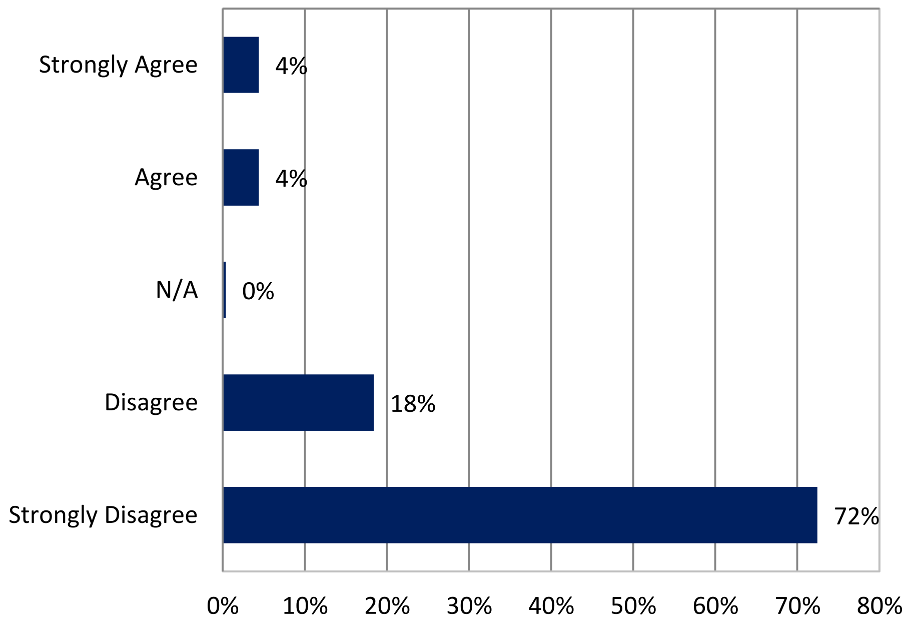
13. Will your business be adversely impacted by having to cease using percentage based asset fees?



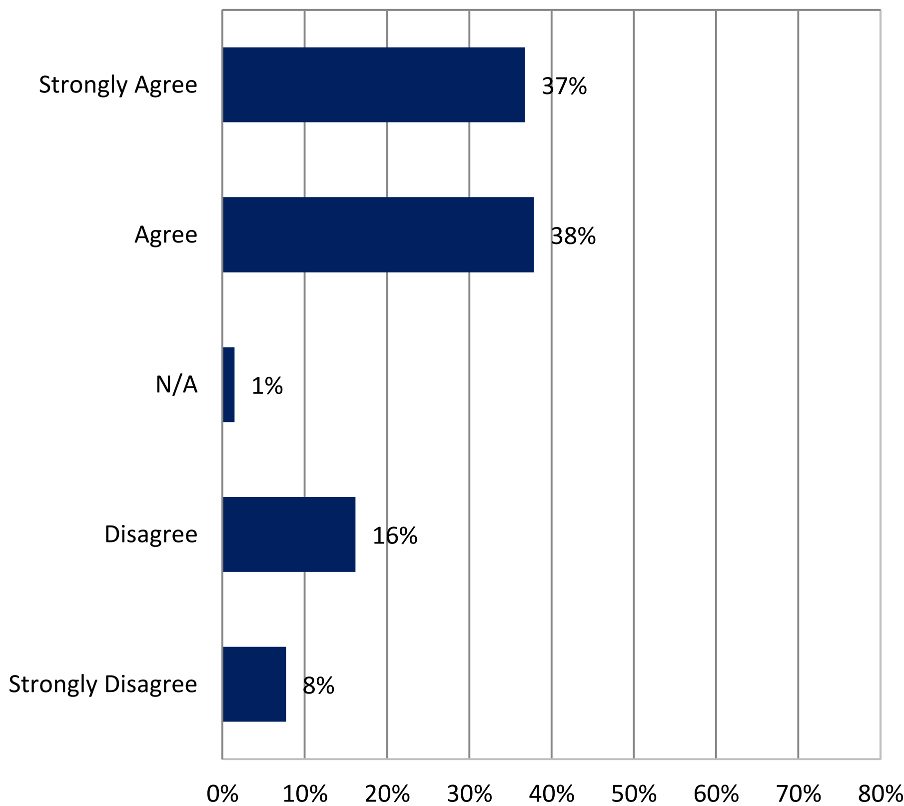
14. With APES 230 prohibiting the receipt of insurance commission, will this seriously reduce the likelihood of providing insurance cover for your clients?



15. APES 230 prohibits the receipt of commissions for services provided prior to the commencement of APES 230. Do you agree with this retrospective application of the proposed standard?



16. Conflicts associated with hourly based remuneration reward inefficiencies, and where the work is drawn out the client will pay more. With asset based percentage fees, when the investment goes up the adviser is paid more and when the investment goes do



Appendix 2 – Adviser Feedback

Adviser comment:
"I believe the powers should be encouraging MORE Australians to seek financial planning advice rather than hindering the process.
On the matter of insurances and commissions I strongly believe that the majority of clients would not be prepared to pay an appropriate fee based on time taken to get many insurance applications. It is very hard to know if it will take 2 hours or 20 hours to get some policy applications through the underwriting process. We take the approach that if it is appropriate for the client we will do it, it may take us 5 years to be fully remunerated, but we have done the right thing by the client."

Adviser comment:
"I am extremely disappointed in this proposal from CPA Australia. I have been providing financial planning advice for over 18 years in an ethical manner and have always put my clients interests first. The accounting bodies seem to want us to head back to the dark ages where hourly rates are the preferred option. We only have to look to our legal system to see the inefficiencies this creates and the resulting impact being the average Australian now unable to afford natural justice."

Adviser comment:
"I think there is no argument from most "trusted" advisers that clients should be provided with a choice of set dollar fees or percentage based fees. In my experience most clients are happy with the concept of a percentage based fee as it in essence performance based.

We have no problem justifying our fees on a fixed dollar/hourly rate arrangement, however it seems harsh that we have spent more contact hours with client over the last 3 years (over serviced) due to market conditions and were getting paid less. To force us to cease this at a time when markets are historically down would impact on our firm substantially.

Removing commissions on insurance would cause an even worse under-insurance problem.

It seems very hypocritical of both the CA and CPA Australia to want to ban all commissions and percentage based remuneration. It is these same organisations that receive large commission payments from AMEX, ING and other co-branded products. These commissions are effectively paid by us, their members."

"Clients should be free to decide the remuneration method that applies.
The issue is discussion and disclosure to the client NOT whether a payment is deemed to be a commission or not.

Clients are well aware of what they are paying and if not happy are free to discuss with us or not be a client - choice is theirs.
Why should we be disadvantaged in the method we charge JUST because we are a member of a professional body?"

Adviser comment:
"In the best interest of the client and their adviser, it is more prudent to delay implementation of APES 230 till the appropriate regulations are legislated, and both clients and advisers have had time to implement the required changes."

Adviser comment:
Our business provides Strategic Financial Planning Advice to the Riverina and around the country. We charge on a "Fee for Service" basis with a hybrid methodology for payments, or as negotiated with the client. This includes a Service Linked fee and an Investment Linked fee, depending on what the client is wanting. We find this works especially well for those clients with employer superannuation or Government super where they really need the structure and strategy advice, but have no actual investments for us to manage on their behalf.

We made the move to a "Fee for Service" style business when we realised that the future of good value Financial Planning was in strategy, not product, around twelve years or so ago. Since then we have tried out several pricing models and settled on the "hybrid" version as providing protection for both the client and the business and allowing us to service those DIY investors and Generation Y who really prefer to do what they can for themselves.

At first we tried going to a purely asset linked percentage based fee by "dialling up" the trailing commission structure to a total 1.10% pa (including GST). This was easy for our clients to understand and did not hurt their cash flow. However, it was not long after this that the correction of 2001/2002 occurred and the subsequent drop in our revenue, when we still had fixed expenses to meet, was quite a burden when we cannot control the markets. It also does not help if we do not manage any investments for our clients (such as when they hold an SMSF managed by their accountant or employer superannuation)

We then moved to a purely service linked flat dollar based fee and rebating all trails where possible. This solved the problem on one hand, we now had a defined income stream from our clients, but even though they were paying the same amount as before for the same services, we found more and more clients were unhappy as this style of fee structure impacted their cash flow a lot more and we ended up pricing some out of the market due to the "perceived" increase in fees and method of payment. Some of our clients refused to change to flat dollar at all as even though they acknowledged that we cannot control the markets, they felt that we could do a better job of advising on their investments if we had some "skin in the game".

Based on these experiences, we moved a number of years ago to a hybrid fee model where we charge a service linked or flat dollar fee for the strategic advice we provide, and charge an asset linked or percentage based fee on any products we manage on their behalf. This enables an opportunity to receive a set income for part of our revenue (presently 50%) and a variable income based on market movement for the rest. It keeps it affordable for us as a business and for our clients.

In our opinion, the difference in the Fees versus Commission debate comes down to "Client Choice". We offer our clients the choice of how they pay our fees and, if we manage investments for them, that includes any trails as the asset linked fee or such is dialled in for that service. The same applies to insurances, where a product is implemented we offer to rebate the commission fee and charge separately for our time involved, however we have only ever had one client take up this offer as the reduction in premiums this gives takes about four to five years to equal the fee we would have to charge to cover the service we provide and the affordability to the client makes the commission option far more user-friendly.

If the government takes away the ability to charge an asset linked / percentage based fee, they are taking away the client's ability to choose what is most appropriate for them. We believe this issue must come down to ***client choice*** *and the* ***value of the advice*** *and service we provide.*