

COMMENTS ON ED 02/10

15 October 2010

APES 230 Financial Advisory Services

TO:

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SELF-MANAGED SUPER FUND
PROFESSIONALS' ASSOCIATION
OF AUSTRALIA



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Self-Managed Super Fund Professionals'
Association of Australia Limited
(‘SPAA’)

Background

1. SPAA is the peak professional body representing the self managed superannuation fund (SMSF) sector throughout Australia. SPAA represents professionals, irrespective of their personal membership and professional affiliations, who provide advice to individuals aspiring to higher levels of participation in the management of their superannuation savings. Membership of SPAA is principally accountants, auditors, lawyers, financial planners and other professionals such as actuaries.
2. A significant number of SPAA members are also members of a professional body that has adopted the APESB professional standards. SPAA has reviewed the Exposure Draft ED 02/10 (‘the Exposure Draft’ or ‘ED’) and wishes to provide comments on various aspects of the proposed standard which, in SPAA’s view, require further clarification or are likely to impose unreasonable and unsustainable obligations on SPAA members who are also members of a professional body that has adopted the APESB professional standards.
3. Comments provided by SPAA are predicated on the assumption that key elements of the Government’s future of financial advice reforms will apply from 1 July 2012. These key elements are:
 - A prospective ban on conflicted remuneration structures, including commissions and any form of volume based payment.
 - The introduction of a statutory fiduciary duty for financial advisors requiring them to act in the best interests of their clients and to place the interest of their clients ahead of their own when providing personal advice to retail clients.
 - The introduction of an advisor charging regime, which retains a range of flexible options for which consumers can pay for advice and includes a requirement for retail clients to agree to the fees and to annually renew (by opting in) to an advisor’s continued services.

1. Definitions

4. The term “Commissions” is broadly defined in the Exposure Draft and includes all monetary amounts received by a Member¹ from an Australian Financial Services Licensee, Client², or other party, in respect of placement or retention of the client’s funds, or purchase or sales of financial or risk products and includes trailing commissions and income.
5. Arguably this definition of commission could include any type of payment including flat dollar fees and other forms of fee for service payments which are received by the Member from a Client or product provider. This definition appears to be inconsistent with references to commission and fee for service payments throughout the Exposure Draft.

¹ A “member” is defined in the Exposure Draft as a member of a Professional Body that has adopted the APESB standards as applicable to their membership, as defined by that Professional Body.

² “Client” for the purpose of the standard means an individual, firm, entity or organisation to whom or to which Financial Advisory Services are provided by a Member.

6. SPAA considers that the term “Commission” should be defined in the Exposure Draft as a payment from a product provider which is set by the product provider and not the Member or Client. This would include all types of embedded product fees such as up-front commissions and trail commissions.
7. The term “Fee for Service” as defined in the Exposure Draft specifically excludes percentage based asset fees. SPAA considers that a Member’s remuneration regime should provide a range of flexible options for which Clients can pay for advice. Ideally, the term “Fee for Service” should be sufficiently broad and incorporate any remuneration regime which enables the Member to charge a fee which is commensurate with the services provided and reflect:
 - The level of training, skill, knowledge and experience of the person providing the service;
 - The level of responsibility (in terms of commercial risk) applicable to the services being provided;
 - The level of complexity applicable to the services provided;
 - The time commitment which will or, has been made by those providing the service; and
 - The level of performance provided.
8. Specifically excluded from the definition of a fee for service payment, should be commission payments.
9. It is not self evident in the Exposure Draft why percentage based fees have been excluded from the definition of “fee for service”. Presumably it is because charging an asset based fee could be considered to be a conflict of interest because the product provider is able to influence the Member’s recommendations and which could also compromise the Member’s professional independence and fiduciary obligation.
10. However, by excluding asset based fees which are set by the product provider (i.e. commission payments), it is difficult to see how the charging of an asset based fee (which under the Government’s new advisor charging regime, will need to be expressly agreed to by the Client on an annual basis) could be considered to be a conflict of interest. It is also difficult to see how the charging of an asset based fee in these circumstances would compromise the Member’s fiduciary duty to the Client.

Recommendation No.1 – *The definition of “Commission” in the Exposure Draft should be amended and should only include payments which are set by product providers. This definition would incorporate all types of embedded product fees.*

Recommendation No.2 – *The definition of the term “Fee for Service” should include the charging of asset based fees and other remuneration models which enable the member to charge a fee commensurate with the services provided. Commission payments should be excluded from the definition of “Fee for Service”.*

2. Professional Independence

11. The Exposure Draft requires Members to comply with the independence requirements contained in laws or regulations, such as the *Corporations Act 2001*. For consistency purposes, SPAA considers that the Professional Independence standard referred to in the Exposure Draft should specifically state that third party payments of embedded product fees

(such as up-front commissions, trail commissions and volume based fees) paid to Members for the provision of a financial advice are prohibited.

Recommendation No.3 – *The Professional Independence standard should make specific reference to the prohibition of third party payments of embedded product fees to Members.*

3. Terms of the Financial Advisory Service

12. The requirement for the Client to expressly agree to the services and fees being charged by Members is not entirely clear in the Exposure Draft. SPAA recommends that the Exposure Draft should make it clear that a Member's charging model must be expressly agreed to by the Client prior to the service being provided. This agreement should establish a clear and written understanding with the Client regarding the terms and conditions under which the fees will be calculated and paid to the Member. This agreement should also require written consent from the Client for the Member to calculate and receive the fees as disclosed in the agreement.
13. The Exposure Draft should also require Members to disclose how their fees will be collected. SPAA would expect that any collection method would be permissible provided all of the standards are complied with. Typically, collection measures would include one or a combination of the following:
 - Direct debit from one or more of the Client's financial products
 - Direct debit from the Client's nominated bank account
 - Invoicing and the receipt of fees via client cheque or EFT.

Recommendation No.4 – *The Exposure Draft should make specific reference to the need for the Client to expressly agree to the fees being charged by Members prior to any fees being charged.*

Recommendation No.5 – *The Exposure Draft should require Members to disclose how their fees will be collected.*

4. Fee for service

14. SPAA considers that Members should be required to charge fees on a fee for service basis as defined. SPAA would expect that Members are able to explain how the fees they charge fairly reflect the work performed. As a starting point, fees should be charged on a flat dollar basis with the fee reflecting the knowledge, skill and experience of the Member.
15. A remuneration model which is based in full or in part on charging asset based fees should be permitted but only if all the other standards are complied with.

5. Soft Dollar Benefits

16. Unless the benefit is trivial or insignificant, the Exposure Draft prohibits Members from receiving Soft Dollar Benefits, gifts or other incentives from a third party related either directly or indirectly to the provision of Financial Advice. SPAA considers that the term "trivial or insignificant" is subjective and is likely to cause confusion and a potential compliance burden for those members who are members of more than one Association.

17. SPAA favours the approach in APS 12 which only requires benefits, gifts and other incentives received by a Member from one source which exceed \$300 over any rolling 12 month period to be subject to mandatory disclosure in the Alternative Remuneration Schedule. This is consistent with the approach required by AFS licensees and, without compromising the integrity of this provision, will ensure the compliance burden is minimised. However, all benefits that influence or are capable of influencing advice, regardless of size, should be disclosed in the Financial Services Guide and Statement of Advice.

Recommendation No.6 – Soft dollar benefits and other incentives received by Members from one source not exceeding \$300 in total over a rolling 12 month period, should be deemed to be trivial or insignificant.

6. Proposed operative date and transitional arrangements

18. The Government's prospective ban on conflicted remuneration structures, advisor charging regime and statutory fiduciary duty (the three key components of the Government's Future of Financial Advice reforms) will apply to new clients from 1 July 2012. However, the proposed operative date for APES 230, for both new and existing clients, is 1 July 2011.
19. SPAA considers that an operative date of 1 July 2011 is likely to cause confusion and Members will have insufficient time to make the system and other changes necessary to conform to the new standards. There are also likely to be product arrangements in place that cannot be unwound without considerable cost and tax implications for Clients. Similarly, there is likely to be issues around legacy products which pay commissions which will need to be considered.
20. Furthermore, the requirement for Members to adopt APES 230 for new and existing Clients from 1 July 2011 will place many Members at a significant commercial disadvantage when compared to those not aligned with a professional accounting body. The prohibition on commission payments will have an impact on revenue streams and may create an un-level playing field for Members in public practice versus those who will only be required to comply with the Government's Future of Financial Advice reforms for new clients from a later date.
21. Given that the detail of the Government's Future of Financial Advice reforms are subject to further industry consultation, and no doubt further change, SPAA considers it appropriate for APES 230 to be introduced only after all of the details of the Government's Future of Financial Advice reforms have been finalised. The Government's consultation process is likely to identify other issues and considerations which should be properly considered prior to the release of the Exposure Draft.
22. However, SPAA does agree that APES 230 (and the Future of Financial Advice reforms when finalised for non-members) should apply to existing Clients but only after an appropriate transitional period. It is difficult to foresee how a regime which provides for different standards to be applied to different Clients could be sustainable or even desirable over the longer term. This transitional period should be sufficient to enable Members to make the necessary changes to their existing charging practices and systems, and should enable Clients to be transitioned to the new fee charging regime in an efficient and orderly manner.

Recommendation No.7 – The operative date for APES 230 should be deferred until after the Government's Future of Financial Advice reforms have been finalised.

Recommendation No.8 – APES 230 should only apply to existing Clients after an appropriate transitional period.

Further Information

We would be pleased to provide you with any further information in support of our comments on ED 02/10.

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