

Agenda Item 4(b) APES 230 CP 01/19 Best Interests and Fees

[CP 01/19 Consultation Paper: Review of APES 230 Financial Planning Services](#) (APES 230 Consultation Paper) sought feedback on various matters including the best interests of the client and fee for service remuneration methodology. APESB received submissions from the following stakeholders:

- Association of Financial Advisers Ltd (AFA)
- Bongiorno Wealth Management Financial Planning (BWM)
- Chartered Accountants Australia and New Zealand (CA ANZ)
- CPA Australia (CPAA)
- Institute of Public Accountants (IPA)
- Pitcher Partners Investment Services Pty. Ltd. (Pitcher Partners)
- Robert Brown AM BEc FCA and Suzanne Haddan FCPA (FPS) CFP (Robert Brown and Suzanne Haddan)
- William Buck Wealth Advisors (SA) Pty Ltd (William Buck)

Best interests of the client

Mixed views were received from stakeholders in relation to the best interests of the client and whether the safe harbour provisions have been effective. The following are summaries from the Draft APES 230 CP 01/19 Specific Comments Table (Agenda Item 4(d)) with relevant Item numbers for cross referencing):

- AFA notes there have been implementation issues with the best interests of the client requirement as per ASIC reports, the effectiveness of the safe harbour provisions will be reviewed by the government in 2022 and in the absence of evidence the safe harbour provisions contribute to poor outcomes that they should be retained (Item 16);
- BWM believes the FASEA Code requirements more adequately ensure the client's best interests are met and refers to Financial Services Royal Commission recommendations to include best interest requirements for mortgage brokers and the review of the safe harbour provisions in 2022. BWM recommends APESB waits until the findings from the 2022 review and the results of the FASEA Code requirements are known (Items 21 & 22).
- CA ANZ believes there is duplication between the requirements in APES 230 and the *Corporations Act 2001* (Corporations Act), the FASEA Code requires a broader duty of care and APES 230 does not include the best interest duties from the Credit Act. CA ANZ recommends that APES 230 should refer to relevant laws relating to best interests and remove other references to it from the standard (Item 17);
- CPAA refers to legislative differences between financial advice provided under an AFSL compared to an ACL and that the Corporations Act definition of best interests of the client may not be relevant to all services captured under the broad definition of financial planning services in APES 230. CPAA also refer to ASIC Regulatory Guide 175 *Licensing: Financial product advisers* and ongoing consultations (Item 18);
- The IPA note that members consulted with have not experienced implementation issues. However, there were divergent views on whether the safe harbour provisions should remain with reference to the Financial Services Royal Commission recommendation to remove it (Item 19);
- Pitcher Partners are of the view the Corporations Act requirements are extensive and that the FASEA Code goes further to require the provider to have reasonable grounds to be satisfied that the client understands, so the definition in APES 230 may need to be expanded beyond the Corporations Act requirements (Item 20).

The following summarises the best interests of the client requirements in APES 230, Corporations Act, the FASEA Code, mortgage broking, and the TPB.

APES 230

Members providing financial planning services must act in the best interests of the client (para 3.6 of APES 230). There are also requirements in APES 230 on disclosure in the terms and financial planning advice regarding acting in the best interests of the client and documentation and quality control.

Best interests of the client in APES 230 means the obligations as defined in Division 2 of Part 7.7A of the *Corporations Act 2001* (Corporations Act) including the 'safe harbour' provisions therein. As per the APES 230 [Basis for Conclusions 2013](#) this definition was adopted and applies to all financial planning services including to wholesale clients. This means all financial planning services subject to APES 230 are currently subject to the same requirements.

Corporations Act

ASIC [Regulatory Guide 175: Licensing: Financial product advisers – Conduct and disclosure](#) (RG175) details ASIC's approach to the best interests obligations in the Corporations Act and the 'safe harbour' provisions in section 961B(2). "*Showing that all of the elements in s961B(2) have been met is one way for an advice provider to satisfy the duty in s961B(1). However, it is not the only way*"¹ as these steps set out a minimum that is expected. Section 961B(2)(g) of the Corporations Act is a 'catch all' provision, which requires 'any other step' to be taken which would reasonably be regarded as in the client's best interest.

The final report of the Financial Services Royal Commission stated

*the safe harbour provision currently has the effect that, in practice, an adviser is required to make little or no independent inquiry into, or assessment of, products. By prescribing particular steps that must be taken, and allowing advisers to adopt a 'tick a box' approach to compliance, the safe harbour provision has the potential to undermine the broader obligation for advisers to act in the best interests of their clients.*²

The Government in consultation with ASIC will undertake a review in 2022 of the effectiveness of various measures, including whether it is necessary to retain the 'safe harbour' provisions in section 961B(2) of the Corporations Act and unless there is clear justification to retain it, it should be repealed.³

FASEA Code

Standards 2 & 5 of the FASEA Code require advisers to act in the best interests of the client. FASEA claims these requirements are broader than the Corporations Act due to the absence of the 'safe harbour' provisions. Standard 2 of the FASEA Code "*you must act with integrity and in the best interests of each of your clients*" in itself does not extend beyond paragraph 3.6 of APES 230 and the requirement to comply with the fundamental principle of integrity in the Code (para 3.3 of APES 230).

Standard 5 of the FASEA Code requires the relevant provider to have reasonable grounds to be satisfied the client understands the advice and the benefits, costs and risks. This is similar to 'informed consent', however, APES 230 currently only extends informed consent to fees based on a percentage of the value of the client's assets or third-party payments.

¹ [Regulatory Guide 175: Licensing: Financial product advisers – Conduct and disclosure paragraph RG 175.259.](#)

² [Financial Services Royal Commission Final Report page 211.](#)

³ Recommendation 2.3 of the Financial Services Royal Commission.

Mortgage Broking

Recommendation 1.2 of the Financial Services Royal Commission was to require mortgage brokers to act in the best interests of clients, which has since been [enacted in legislation](#) and became effective 1 July 2020, however, [ASIC has provided an exemption until 1 January 2021](#). These new requirements include a duty to act in the best interests of consumers and require mortgage brokers to prioritise the consumer's interests. The obligations are principles based and do not contain 'safe harbour' provisions equivalent to those in the Corporations Act. "*The best interests obligations apply only in relation to credit products that are regulated under the National Credit Act—that is, products provided to consumers for personal, domestic or household purposes or for the purchase or improvement of residential investment property.*"⁴

ASIC released [Regulatory Guide 273 Mortgage brokers: Best interests duty](#) (RG273) on 24 June 2020. RG273 provides guidance on what ASIC will look for to determine if the best interest obligations under Part 3-5A of the National Credit Act, setting out the principles ASIC will apply and what ASIC expects of brokers. However, the National Credit Act and ASIC RG 273 do not include the notion of leaving the client in a 'better position' as per the Corporations Act and RG 175. Technical Staff are of the view that APES 230 should strive to require the highest level of standards for members in the provision of financial planning services.

Tax Practitioners

In addition to the above, those members registered with the Tax Practitioners Board (TPB) are subject to the TPB's Code of Professional Conduct. The TPB have provided a high level summary [Comparing the TPB's Code with the Corporations Act and FASEA Standards](#).

Fees/Remuneration

Remuneration methodology remains a contentious issue with all stakeholders expressing strong views:

- AFA believe there is no need to remove either asset-based fees (as some clients prefer this method and should have the ability to make this choice) or life insurance commissions (due to the Life Insurance Framework (LIF) and parliament has allowed their continuation under LIF and if forced to change it would create substantial impacts (Item 23);
- BWM is of the view that the LIF established from 1 January 2018 should be able to run its course, as long as client consent is obtained, and that APES 230 should be aligned to the Government's approach to conflicted remuneration (Items 29 and 31);
- CA ANZ support the removal of grandfathered conflicted remuneration and other banned remuneration unless this is not in the best interests of the client. They advocate that asset-based fees, volume-based fees and third party payments (subject to laws and regulations) should be banned from 1 January 2021 and fee for service should be the preferred method provided commissions (where the associated product cannot or should not be sold or replaced) can be offset against the fee. CA ANZ also believe product providers should be required by law to rebate ongoing commissions directly to the client (Item 24);
- Although supporting a transition to fee for service models, CPAA believes that this is problematic due to the breadth of the scope of APES 230, which includes credit advice, that is mainly commission-based and not prevented by legislation. Further, CPAA note that banning commissions may be contrary to the Code, which allows commissions as long as threats are reduced to an acceptable level. CPAA recommend that APES 230 be consistent with requirements in legislation, regulation and the Code and any

⁴ [ASIC Regulatory Guide 273: Mortgage brokers: Best interests duty paragraph RG273.5](#).

deviation must be based on clear public interest arguments (Item 25 and General Comment Item 22);

- Members of the IPA that were consulted with noted widespread but not unanimous support for the fee for service approach with arguments presented for benefits of asset-based fees in certain instances (Item 26);
- Pitcher Partners believe the assumption that fee for service model is the only one that represents the client’s best interests is incorrect and that core principles should be applied rather than banning asset-based fees and provide several different examples/scenarios to support their view. Pitcher Partners are of the view that any fee structure must be in the client’s best interest, in accordance with the law, transparent and appropriately disclosed, accepted by the client and not collected where no service is provided (Item 27);
- Robert Brown and Suzanne Haddan advocate for APES 230 to only allow the fee for service remuneration method to ensure that accountants adopt the highest ethical standards. They believe it is important for APES 230 to include this requirement to capture services, such as mortgage broking and real estate services, that are outside the FASEA Code (Item 28); and
- William Buck believe there is significant legislation in place to ensure that clients receive high-quality services, that APESB should not dictate how financial planning or mortgage broking businesses should be remunerated and that charging based on funds under management in many situations is the most appropriate method. They also believe the legislation/regulation in respect of commissions is now appropriate and clients *“in most instances prefer to pay for insurance and mortgage broking services via a commission payment.”* (Item 30)

The following summarises/analyses arguments (including those presented in submissions) for and against the various fee structures used in financial planning services:

Fee Structure	Arguments For	Arguments Against
<p>Fee for Service</p>	<p>Fee for service is the preferred method as long as commissions (if the product cannot or should not be sold in the best interests of the client) can be offset against fees or rebated to the client from product providers.</p> <p>A genuine fee for service approach without any caveats or carve-outs represents the highest ethical standards which is what is expected by the Australian community.</p> <p>A uniform approach to remuneration should be applied irrespective of the type of financial planning service provided.</p> <p>Fee for service:</p> <ul style="list-style-type: none"> • Promotes integrity and objectivity. • Is free from inherent conflict and clients know what services they are paying for. • Is most likely lower than asset-based or third-party fees, 	<p>Only allowing fee for service may deviate from the Code, which allows commissions if the member informs the client in writing of required information.⁵ However, informed consent is more stringent than these requirements and members must not allow a conflict of interest to compromise professional or business judgement⁶ which could result from commissions.⁷</p> <p>Hourly rates may not appear to add value for the clients, for example onboarding clients or undertaking an extensive review of clients’ positions which results in minimal changes.</p> <p>Financial advisers may need to increase workload and fees in economic downturns when a client is suffering losses and/or clients may be unwilling to approach advisers resulting in missed opportunities.</p>

⁵ [Paragraph AUST R330.5.1 of APES 110.](#)

⁶ [Paragraph R310.4 of APES 110.](#)

⁷ [Paragraph 310.4 A1 of APES 110.](#)

Fee Structure	Arguments For	Arguments Against
	<p>particularly when markets are strong.</p> <ul style="list-style-type: none"> • Puts the client's interests first. • Provide competitive advantage for accountants over financial planners. 	<p>Fixed fee or fee for service costs bring forward onboarding costs which may be a disincentive for clients to proceed.</p> <p>Fixed-fee arrangements may not be in the client's best interests as the fee is the same regardless of outcomes.</p> <p>Legislation has not mandated fee for service.</p>
<p>Asset-based fees</p>	<p>Asset-based fees:</p> <ul style="list-style-type: none"> • Do not prevent financial services providers from stating they are independent.⁸ • Should be allowed where research and effort are undertaken to grow portfolios and should be commensurate with results. • Related to portfolio management, educating clients on investment complexities and superannuation, and ongoing research can replace fees for preparation of a SoA. • Mean the adviser and client benefit when markets are strong. • Of larger clients may subsidise retail clients. • Amortises onboarding costs over several years incentivising advisers to develop stronger long-term relationships and investment outcomes. • May be more beneficial to clients during economic downturns. • Involve a number of variables and variations and advisers should be able develop fee structures in the client's best interest. <p>Fees based on funds under management in many situations is the most appropriate form of remuneration and is readily understandable.</p> <p>Discontinuing asset-based fees would result in significant impact and costs to negotiate new fee arrangements that may be unrecoverable.</p> <p>Accountants see clients more regularly for other matters, so financial planners are reliant on asset-based fees.</p>	<p>Funds under management create an actual or perceived conflict of interest as there is an incentive to recommend that clients maintain assets rather than pay down a loan as this would maintain a higher level of asset-based fees, which may not be in the client's best-interests.⁹</p> <p>Asset-based fees must not be charged on a borrowed amount used or to be used to acquire financial products (s964D of the Corporations Act).</p> <p>Asset-based fees should be banned from 1 January 2021 (subject to laws and regulations).</p>

⁸ [ASIC Regulatory Guide 175 para 175.74.](#)

⁹ [Basis for Conclusions: APES 230 Financial Planning Services \(Formerly APS 12\) page 7.](#)

Fee Structure	Arguments For	Arguments Against
Volume-based fees		<p>Remuneration based on the quantity of product sold creates an actual or perceived conflict of interest as it is in the member's interest to sell more of the product to the client, which may not be in the client's best-interests.¹⁰</p> <p>Remuneration based on volume of business placed with a financial product issuer¹¹ would prevent the use of 'independent'.¹²</p> <p>Volume-based fees should be banned from 1 January 2021 (subject to laws and regulations).</p>
Commissions	<p>Banning life insurance commissions would make provision of these services unsustainable (only 8% of clients are willing to spend over \$1,000 for advice that costs \$2,500) resulting in less life insurance and a poor outcome for clients and Australia.</p> <p>Clients prefer to pay for insurance and mortgage broking services via commissions and there are significant costs incurred when providing these services.</p> <p>Third-party fees should be allowed where the financial services provider undertakes research and effort to grow portfolios and should be commensurate with results.</p> <p>Accountants see clients more regularly for other matters so financial planners are reliant on third-party fees.</p> <p>Certain benefits to mortgage brokers are not deemed to be conflicted as set out in the regulations.</p>	<p>Third party payments (commissions) create a self-interest threat as they are not transparent payments and advice could (or be perceived) to be influenced by the payments.¹³</p> <p>Grandfathered conflicted remuneration will be prohibited from 1 July 2021.</p> <p>ASIC is reviewing conflicted remuneration in 2021 and will consider reducing the cap on life insurance and unless there is a clear reason to retain commissions, the cap should be reduced to zero.¹⁴</p> <p>Third-party payments should be banned from 1 January 2021 (subject to laws and regulations).</p> <p>Commissions should be discontinued with a transitional period of up to three years for existing arrangements.</p> <p>From 1 January 2021 mortgage brokers must not accept conflicted remuneration and the regulations ban volume-based and campaign-based benefits and for certain residential property loans, commissions must be based on the amount drawn down in the first year.</p>

¹⁰ [Basis for Conclusions: APES 230 Financial Planning Services \(Formerly APS 12\) page 7.](#)

¹¹ Section 923A(2)(a)(ii) of the *Corporations Act 2001*.

¹² [Paragraph RG 175.76 of ASIC Regulatory Guide 175.](#)

¹³ [Basis for Conclusions: APES 230 Financial Planning Services \(Formerly APS 12\) page 8.](#)

¹⁴ Recommendation 2.5 of the Financial Services Royal Commission.