

AGENDA PAPER

Item Number: 6
Date of Meeting: 6 September 2021
Subject: Project Update on APES 230 *Financial Planning Services*

Action required For discussion For noting For information

Purpose

To:

- update the Board on the APES 230 *Financial Planning Services* (APES 230) project and Technical Staff's analysis of retail and wholesale clients; and
- obtain the Board's approval for the proposed way forward for the APES 230 project.

Background

APES 230 was issued in April 2013, with an effective date of 1 July 2014 (with sections relating to remuneration effective on 1 July 2015). APES 230 was revised in December 2019 (effective 1 July 2020) to align with the restructured Code, change from a biennial to annual written consent to continue charging fees on a percentage basis and remove transitional provisions.

Since APES 230 was first issued, there have been ongoing political, legislative, and regulatory changes in the financial planning industry. A summary of all the actions taken by APESB to consider these changes and an update on the *Consultation Paper: Review of APES 230 Financial Planning Services* were presented at the June 2020 Board meeting ([Agenda Item 9](#)).

A further update was provided at the November 2020 Board meeting ([Agenda Item 4](#)). The Board discussed the purpose of APES 230 in setting the professional and ethical standards for accountants, existing regulations and guidance and the six ethical principles outlined in the final Financial Services Royal Commission (FSRC) report.

The Board directed Technical Staff to engage with ASIC and FASEA and provide an update at the March 2021 Board meeting. The status of APES 230 was considered at the March 2021 Board meeting ([Agenda Item 8](#)), including CPA Australia's request in December 2020 for APESB to suspend APES 230, which cannot be done under APESB's governing documents. The Board discussed APES 230's relevance and consumer interest focus and agreed it should continue as an issued standard. The Board reiterated their view that they hope that each Professional Body will support APES 230 given its public interest perspective and supported Technical Staff to continue monitoring the legislative and regulatory environment.

Matters for Consideration

1. Legislative and Regulatory Update

There have been significant ongoing changes to legislation and regulations in the financial planning industry since March 2021, which are likely to be protracted, and the eventual impact on APES 230 will not be able to be determined, evaluated and managed until the regulatory process has concluded. The following summarises the main legislative and regulatory changes.

FASEA Update

On [9 December 2020](#), the Federal Government announced that ASIC's Financial Services Credit Panel (FSCP) would become the single disciplinary body for financial advisers in line with recommendation 2.10 of the FSRC and FASEA's standards development functions, including the FASEA Code of Ethics (FASEA Code) would be transferred to Treasury.

Treasury released an [Exposure Draft](#) and associated documents on 19 April 2021 (open for comment until 14 May 2021), which included FASEA to be wound up on 1 January 2022. FASEA's standards for education and training and the FASEA Code will remain operational even when FASEA is wound up. However, the Minister can amend these by legislative instrument. The [FAQs](#) highlight that the Government is aware of the industry's concerns about the FASEA Code, has not made any decisions to change it, and will not do so without further industry engagement.

This legislation was introduced to Parliament on 24 June 2021. Treasury also released a [Single Disciplinary Body: Policy Paper](#) on 6 August 2021 (open until 20 August 2021), seeking feedback on the circumstances when ASIC must convene the single disciplinary body and administrative sanctions to be included on the Financial Adviser's Register.

FASEA will continue to administer its functions until it is wound up. FASEA will undertake further consultations on the wording and interpretation of Standard 3 of the FASEA Code¹ during the second half of 2021 to ensure it is understood and workable and will liaise with Treasury to inform future decisions about the FASEA Code.²

Tax (Financial) Advisers

The above mentioned [Exposure Draft](#) will also result in those who provide tax (financial) advice only needing to register with ASIC and not with the Tax Practitioners Board. This is in response to recommendation 7.1 of the FSRC to have a single registration and disciplinary system for financial advisers that provide tax (financial) advice.

ASIC report on ending grandfathered conflicted remuneration

ASIC issued a report on 16 July 2021 [Ending grandfathered conflicted remuneration](#), which resulted from a direction on 21 February 2019 under section 14 of the *ASIC Act 2001* to investigate the financial planning industry's transition from grandfathered conflicted remuneration (GCR).

The report covered the period 1 July 2019 to 31 December 2020 (the review period) before the ban on GCR commenced on 1 January 2021 (with rebating available from that date). ASIC surveyed the 10 largest AFSLs and included 93 product issuers responsible for 1,323 products, which ASIC believe represents the vast majority of product issuers paying GCR during the review period.

¹ "You must not advise, refer or act in any other manner where you have a conflict of interest or duty".

² [Page 5 of FASEA's Opening Statement to Senate Estimates Committee 2 June 2021](#).

The following summarises the main results of the report³:

- In the 2018/19 period (before the review period), 93 product issuers paid \$816.1m GCR on 1,323 products relating to more than 2.5m client accounts.⁴
- During the review period, 89 product issuers paid \$760.5m GCR on 1,273 products. This amounted to \$507m annualised, but the majority was paid early in the review period and decreased as arrangements were terminated.
- 96% of GCR arrangements on 1,227 products were terminated during the review period, and the majority (837) were terminated in December 2020.
- With the remaining 4% or 46 products that were not terminated, the 8 product advisers had rebate arrangements in place on 1 January 2021, and ASIC will follow up with these advisers about their obligations.
- \$266.7m was voluntarily rebated during the review period on 755 products.
- Financial advisers changed how they charged clients over the review period, moving to ongoing fees, hourly rates, fixed prices, or asset-based fees.
- Those unable to transition product holders to alternative fee arrangements either provided services pro bono or stopped providing services, and many businesses had material reductions in income (15-20%).

Technical Staff believe the results of ASIC's investigation highlight the ability of the financial planning industry to transition away from conflicted commissions and within a relatively short time period. Further, revenue losses up to 20% of the GCR could represent fees where no service was previously provided, which was no longer recoverable under other methods such as ongoing fees or hourly rates.

Other Financial Services Royal Commission and Industry Updates

[ASIC released guidance](#) on 15 June 2021 for ongoing fee arrangements, which took effect on 1 July 2021 under legislation⁵ to implement FSRC recommendations:

- 2.1 – annual renewal of ongoing fee arrangements and AFSLs not to deduct ongoing fees without client consent;
- 2.2 – AFSLs to disclose lack of independence where they would breach the *Corporations Act 2001* by using restricted terms 'independent', 'unbiased' and 'impartial'; and
- 3.3 – limit fee advice deductions from superannuation choice accounts.

Agenda Item 6(a) includes other FSRC and industry updates relevant to APES 230.

³ Sourced from [Ending grandfathered conflicted remuneration - June 2021 \(treasury.gov.au\)](#)

⁴ Not including other permitted exemptions, such as commissions on risk or general insurance, commissions on timeshares and mortgage brokers.

⁵ [Financial Sector Reform \(Hayne Royal Commission Response No. 2\) Act 2021](#)

2. Australian Law Reform Commission – Financial Services law simplification

The Australian Law Reform Commission (ALRC) is undertaking an inquiry to simplify Australian financial services law in response to the FSRC.⁶ The inquiry is focussing on making the legislation more adaptive, efficient and navigable within existing policy settings and the [Terms of Reference](#) cover three broad matters:

- Definitions used in corporations and financial services legislation;
- The coherence of regulatory design and hierarchy of laws; and
- Restructuring Chapter 7 of the *Corporations Act 2001* and *Corporations Regulations 2001* to be clearer, coherent and effective.

ALRC President, Hon. Justice Sarah Derrington believes pulling Chapter 7 out of the *Corporations Act 2001* would reduce complexity by clarifying that the *Corporations Act 2001* only covers the regulation of the life of companies and to create a self-contained financial services legislation including consumer protections.⁷ The ALRC's interim reports are due 30 November 2021, 30 September 2022 and 25 August 2023, with the final report due 30 November 2023. Any legislative changes resulting from the ALRC's recommendations would likely take a considerable amount of time after this to be implemented.

3. Retail vs. Wholesale Clients

APES 230 defines the Client in a manner to capture all Clients and does not distinguish between retail and wholesale, so the same standards of Professional Service are provided to all Clients.⁸ Further, the definition of Financial Planning Advice makes it clear that the advice is concerning personal affairs related to wealth management, retirement planning, estate planning, risk management and related advice.

APES 230 has broader coverage than the FASEA Code as it includes all wholesale clients and retail clients in relation to personal affairs and captures activities not within an AFSL.

APESB Technical Staff met with Stephen Glenfield, FASEA CEO, on 7 May 2021 and discussed APESB's [High-Level Comparison of Key Elements of FASEA Code and APES 230](#). Mr Glenfield concurred with this comparison. However, he noted that FASEA's scope covers retail financial products and, in some instances, wholesale clients.

FASEA Standard 1 states, "You must act in accordance with all applicable laws, including this Code, and not try to avoid or circumvent their intent". FASEA's [Financial Planners & Advisers Code of Ethics 2019 Guide](#) states that despite the *Corporations Act 2001* defining a wholesale client based on assets, Standard 1 of the FASEA Code encourages advisers to use professional judgement about the Client's financial literacy and whether it's more appropriate to treat them as retail clients and provides a specific example addressing this issue.

The meaning of retail Client under the *Corporations Act 2001* is given by sections 761G and 761GA. A wholesale client is a person that is not a retail client (section 761G(4) of the *Corporations Act 2001*) and can access more investments but does not have the same protections as a retail client.

⁶ [Review of the Legislative Framework for Corporations and Financial Services Regulation | ALRC](#)

⁷ [Corps Act split would separate companies from consumers: ALRC President | Professional Planner](#)

⁸ [Basis for Conclusions - APES 230 \(apesb.org.au\)](#)

The legislation to determine whether a client is retail or wholesale is fairly complex, with a general premise that clients should be treated as retail clients, but there are certain 'exemptions' which, if met, means the Client can be treated as wholesale. These rules depend on the type of financial product and the nature of the Client and generally include⁹:

- If the financial services relate to certain prescribed general insurance products, the Client is always a retail client if they are a person or the product will be used in connection with a small business.
- If the financial services relate to superannuation or retirement savings account, the person to whom the advice is provided is generally a retail client unless, for example, they are a trustee of a SMSF that has net assets in excess of \$10m.
- If the financial services relate to other products (i.e., not related to general insurance or superannuation), the Client (person) will be a retail client unless:
 - they have a certificate from a qualified accountant that their net assets are at least \$2.5m or their gross income was \$250,000 or more per annum in each of the previous two years;
 - they are a 'professional investor' such as holding an AFSL, body regulated by APRA or controls at least \$10m; or
 - the AFS licensee provides the advice and is satisfied on reasonable grounds the Client is a 'sophisticated investor' due to appropriate prior experience and the Client has signed the appropriate acknowledgement.
 - the advice is provided for use in connection with a business that is not small.
 - the financial product's price or value is worth more than \$500,000.

Pamela Hanrahan, professor of commercial law and regulation at UNSW and who advised the FSRC, believes "*there is a pressing need to update or radically alter the current definitions of retail and wholesale clients*", the threshold between the two has not changed since 1994, that retail clients should be 'household clients' and afforded protections up to \$10m.¹⁰

The ALRC review of financial planning services legislation (discussed above) may address this issue in the first interim report due 30 November 2021, which is focussed on definitions including '*the appropriate design of legislative definitions*'.¹¹ Technical Staff will review the results from the ALRC interim report when it is released.

Technical Staff are of the view that APES 230 should continue not to make a distinction between retail and wholesale clients so that financial planning services in relation to personal wealth management affairs continue to be subject to the same standards.

4. Impact on small and medium practices (SMPs)

At this stage, there are no changes proposed to APES 230 and as such, there will be no impact on SMPs. However, Technical Staff note that the COVID-19 pandemic and the significant level of current and ongoing regulatory change and uncertainty in the financial planning industry will be having a marked impact on SMPs. Therefore, Technical Staff recommend that APESB continue to monitor these changes and their impact and consider them in any future deliberations related to APES 230.

⁹ Table 4 of [ASIC Regulatory Guide 175: Licensing: Financial product advisers – Conduct and disclosure](#) and [What can limited AFS licensees do? | ASIC - Australian Securities and Investments Commission](#)

¹⁰ [Hanrahan: Updating retail/wholesale client definitions 'urgent' | Professional Planner](#)

¹¹ [Terms of Reference | ALRC](#)

Way Forward

Technical Staff propose, subject to the Board's approval, the following actions in respect of the APES 230 project:

- continue monitoring the legislative and regulatory environment in the financial planning industry flowing from the implementation of the FSRC's recommendations and the transition of FASEA's roles and requirements to ASIC and Treasury; and
- provide further updates to the Board at future Board meetings.

Recommendations

That the Board:

- note the update on the APES 230 project and Technical Staff's analysis of retail and wholesale clients; and
- approve the proposed way forward to progress the APES 230 project.

Materials Presented

Agenda Item 6 (a) Other FSRC and industry updates

Author: Jon Reid

Date: 26 August 2021