Pitcher Partners Investment Services Pty. Ltd.
ABN 24 052 941 036
AFS LICENCE NO. 229887

Level 13, 664 Collins Street
Docklands, VIC 3008

Level 1, 80 Monash Drive
Dandenong South, VIC 3175

Postal address
PO Box 1297
Melbourne, VIC 3001

p. +61 3 8610 5000

Ref: ADS:GG

14 February 2020

Mr Channa Wijesinghe
Chief Executive Officer
Accounting Professional & Ethical Standards Board Limited
Level 11
99 William Street
MELBOURNE VIC 3000

By Email: *sub@apesb.org.au*

Dear Channa

CONSULTATION PAPER: REVIEW OF APES 230 *FINANCIAL PLANNING SERVICES*

Thank you for the opportunity to consider Consultation Paper 01/19 and to provide our views as a stakeholder in respect of issues raised and the impacts of APES 230 and its application on our profession and our business.

The Current Environment for Financial Planning Services

The financial services industry is possibly the most highly regulated industry within Australia, with additional laws and regulations being introduced even as we prepare this response.

Within this industry, the providers of financial planning and investment advisory services are perhaps the most regulated of all industry participants and the recent introduction of The Financial Adviser Standards and Ethics Authority (FASEA) is further evidence of this regulation. This body has been charged with the responsibility for developing the standards and ethics under which all ASIC registered financial advisers must comply.

In recent times, the industry has received poor publicity and regulatory attention, particularly across the corporate financial services and banking sectors of the Australian market. The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission), and the APRA Laker prudential inquiry into the Commonwealth Bank of Australia are just two examples.

As a result of the Financial Services Royal Commission findings and the recommendations contained within the final report, the corporate players in this space are remediating, spinning off and/or are selling their financial planning, investment advisory, insurance and investment management divisions. We are beginning to see a rise in independently owned financial planning and investment advisory firms and a highly competitive market place.

There were 76 recommendations proposed by the Financial Services Royal Commission and it is expected that each of these recommendations will be implemented in full. Only a few of these recommendations have been implemented to date.

In addition, the regulatory environment within Australia has become more adversarial. ASIC, AUSTRAC, APRA and other government bodies are taking a 'why not litigate?' stance to deter future misconduct and to address community expectations. This is creating a challenging environment as industry participants are likely to be penalised even for self-reporting.

In this market place, the rising costs of compliance and the introduction of the new education requirements are placing the industry and many of its participants under a great deal of stress and regulatory fatigue. Advisers are leaving the industry in large numbers and we believe this exodus will continue for the next few years.

Application of the FASEA Code of Ethics

We note on page 7 of your consultation paper that "APES 230 impacts upon a broader population of clients than the FASEA Code as it covers all clients (not just retail clients) and includes services provided under an ACL." We do not agree with your position that FASEA only applies to retail clients as the application of FASEA is to the adviser and not the client. FASEA applies to any relevant provider who provides personal advice to a retail client and who therefore must be registered on the ASIC Financial Adviser Register (FAR). It is our understanding that the FASEA Code will apply to any advice provided by a relevant provider, regardless of whether the advice is provided to a retail or wholesale client.

Pitcher Partners Investment Services Pty Ltd holds an AFSL with scope to provide personal advice and to deal in a broad range of products. As such, all representatives are deemed to be relevant providers and are required to be registered on the ASIC Financial Adviser Register (FAR). All relevant providers are therefore required to comply with the FASEA Code of Ethics. A representative cannot avoid the application of the Code simply because the client satisfies a 'wholesale client' test.

The FASEA Code of Ethics only commenced from 1 January 2020 and the FG002 Financial Planners and Advisers Code of Ethics 2019 Guidance was recently released. We believe there will be further clarification issued to the industry over the course of 2020.

In light of this expected clarification and the changing regulatory environment, we question whether it is an appropriate time to be contemplating substantial changes to APES 230.

APES 110 Code of Ethics for Professional Accountants (including Independence Standards)

As a member of a Chartered Accounting firm, Pitcher Partners Investment Services Pty Ltd and its representatives are required to comply with the Professional Standards. As such, Pitcher Partners Investment Services Pty Ltd and its representatives are expected to observe the Australian Professional and Ethical Standards Board (APESB) 110 – Code of Ethics for Accounting Professionals.

The Code requires Members to comply with the five fundamental principles of ethics including integrity, objectivity, professional competence and due care, confidentiality and professional behaviour. The Code also requires Members to apply the conceptual framework to identify, evaluate and address threats to compliance with the fundamental principles. Applying the conceptual framework requires exercising professional judgement, remaining alert for new information and to changes in facts and circumstances, and using the reasonable and informed third party test.

These fundamental principles and the conceptual framework will apply in all circumstances when a Financial Planning Service is being provided by a member firm or a representative of a member firm.

PITCHER PARTNERS

Fee for Service

We disagree with your position that "There is now also a broader shift towards fee for service in respect of financial services from both a legislative and regulatory perspective". While there have been bans on commission and other forms of conflicted remuneration, no legislation or regulations have been passed or proposed which require a 'fee for service' arrangement other than by the default banning of conflicted remuneration.

We also disagree with your position that there has "been a broader focus" within the industry on fee for service arrangement "as a way of enhancing the independence and quality of financial planning advice". Any suggestion that quality is enhanced under a fee for service model is misleading and wrong.

Financial planning advice provided in isolation (i.e. no product advice) has always been charged on a fee for service basis. This has not changed.

In addition, the claim that there has been a broader shift towards fee for service is a statement that hides the fact that advisers have been forced away from conflicted remunerations such as commission-based remuneration.

You then provide two examples to support your claim. The ADF Financial Services Consumer Centre only provides a referral program and does not restrict personnel to fee for service advice. The Profession of Independent Financial Advisers (PIFA) (previously the Independent Financial Advisers Association of Australia) has only approximately 50 advisers from across Australia despite being in existence for several years.

These examples are hardly supportive of a 'broader focus' or a 'broader shift' and are not representative of the industry or of Members of the professional accounting bodies.

You undertake no analysis with respect to the underlying client bases (e.g. age, wealth, stages of life, needs and profiles, etc), the investment platforms used, amounts of investments offered (if at all), the complexities of the clients or the relative successes of these firms in winning and retaining clients during all market conditions.

Consultation Paper Questions

1. In view of substantial changes in the financial services industry since APES 230 became effective in July 2014:

   a) Do you consider that APES 230 remains fit for purpose?
   b) What amendments or enhancements, if any, should be made to APES 230?
   c) Are there any tools or templates that could be included in APES 230 to assist with complying with the standard?

As a member of a large accounting firm, we recognise the importance of the accounting professional and ethical standards and continue to encourage and support their development. These standards are essential for the ongoing growth and advancement of our profession, the provision of protections for all parties relying on Member services and the overall confidence in the profession. Accounting standards provide guidance and clarification and establish core principles in areas which would otherwise not be properly governed.

However, while we recognise the value of accounting standards in unregulated or lowly regulated environments, care needs to be taken when introducing accounting standards in highly regulated and changing areas of the law. Care must also be taken when applying accounting standards to other professions such as financial services. It is essential that the standards are progressive, have the support of the Members that they are seeking to

PITCHER PARTNERS

regulate, do not restrict innovation and progress and do not place its members at a competitive disadvantage.

While largely mirroring the onerous requirements of the Corporations Act (2001), APES 230 increases obligations in respect to credit advice and advice provided to wholesale clients. In our view it remains fit for purpose, but we caution against the expansion of the standard in the current regulatory environment and especially with the very recent introduction of the FASEA Code of Ethics and the release of FG002 Financial Planners and Advisers Code of Ethics 2019 Guidance. While the FASEA Code of Ethics is unlikely to change, the guidance and interpretation of the Code is expected to be heavily debated over the course of 2020 and beyond. We believe alignment with the FASEA Code of Ethics is important.

Pitcher Partners Investment Services Pty Ltd would be supportive of APES 230 being reviewed for ongoing compliance with the Corporations Law and its general alignment with the FASEA Code of Ethics. This would ensure that professional accountants would be expected to follow the FASEA Code of Ethics regardless of the scope or type of AFSL (or ACL) held. It would also ensure that services limited to only wholesale clients would be covered.

2. Do you believe that the definition of Financial Planning Advice in APES 230 captures all the relevant advice, products and services provided by members, including advice not provided under an AFSL or ACL such as real estate advice and non-product advice related strategies? If not, please provide an explanation and any recommendation or amendments to this definition to capture relevant Financial Planning Advice provided to a Client?

The current definition of Financial Planning Advice limits the application of APES 230 to advice in respect of a Client's 'personal financial affairs' but does not properly define 'personal'. The term 'personal' does not directly align with the term 'consumer' in the National Consumer Credit Protection Act 2009 (NCCPA) or with the terms 'wholesale or retail client' in the Corporation Act 2001.

The term 'personal' is generally defined to mean "something that belongs to or affects a particular person rather than anyone else". An alternative definition might be "concerning one's private life, relationships, and emotions rather than one's career or public life". Either way, the term and its use in this context appears to limit the application of APES 230 to individual circumstances.

This term therefore creates confusion and inconsistency in its application. A commercial loan is not a 'personal financial affair'. An investment portfolio for a not-for-profit organisation is not a 'personal financial affair' and yet this portfolio may not satisfy the wholesale client definitions within the Corporations Act (and is therefore considered a retail client).

We don't believe it was the intention of APESB to create these scenarios. We believe, for example, that APESB was seeking to prohibit Members from accepting any form of commission – not just commissions in respect to personal loans.

We are also unsure why selected financial products such as derivatives have been omitted from the definition within APES 230.

We believe this definition should be changed as follows:

Financial Planning Advice includes:

a) advice on 'financial products' as defined in section 763A of the *Corporations Act 2001* provided pursuant to an Australian Financial Services Licence;
b) 'advice and dealing' in financial products as defined in section 766C of the *Corporations Act 2001*;

PITCHER PARTNERS

c) advice and services related to the procurement of loans and other borrowing arrangements, including credit activities provided pursuant to an Australian Credit Licence; and
d) other advice such as taxation, real estate and non-product related advice on financial strategies or structures provided as part of the advice under (a) – (c).

3. APES 230 requires Members to act in the '*Best Interests of the Client*' (as per the *Corporations Act 2001*):

   a) Have there been any implementation issues in respect of this requirement?
   b) Do you consider the 'safe harbour' provisions in the Corporations Act 2001 ensure clients' best interests are met?

We believe that the best interest duties outlined in Section 961B are extensive and relevant to any advice provided under an AFSL.

The FASEA Code of Ethics, in a general sense, and Standard 5 specifically also reinforce the obligations on Advisers that all advice and financial product recommendations must be in the best interests of the client and appropriate to the client's individual circumstances. The Code goes one step further by requiring the relevant provider to have reasonable grounds to be 'satisfied' that the client understands the advice, and the benefits, costs and risks of the financial product recommended.

Acting in the 'best interests of the client' has become a critical component of any adviser's advice and must be foremost in every decision and action the adviser takes. The 'why not litigate' attitude of the regulators and the threat of client complaint and/or litigation is driving the industry, licensees and advisers in this regard.

The definition of '*Best Interests of the Client*' within APES 230 limits the best interest duties to Division 2 of Part 7.7A of the Corporations Act 2001 and may need to be expanded to incorporate the principle within Standard 5 of the FASEA Code of Ethics.

4. APES 230 currently allows remuneration as fee for service, asset based fees and third party payment (subject to laws and regulations). If APES 230 is limited to only allow fee for service:

   a) What are the challenges, if any, that Members consider would result from implementing these changes?
   b) Are there any transitional arrangements required?

The position of APESB in respect to fees appears to be premised on the assumption that only a fee for service model represents the client's best interests and is free from conflict. We believe this assumption is incorrect. Every fee model has embedded conflicts of interest that may only become apparent in certain circumstances.

A fixed fee arrangement may not align the client's best interests with the adviser. The adviser will collect the same fee at all times, regardless of the outcomes for the client. This fee does not automatically adjust during market downturns or when workloads reduce. An adviser on a fixed fee arrangement will benefit during significant market downturns when compared to an asset-based fee arrangement.

An hourly rate may not align the client's best interests with the adviser. If an adviser undertakes work that takes a lot of time but does not appear to add value to the client, then how do they charge for this? Do they even bother to undertake the work? The onboarding of a client is one such example. Another is an extensive review of a client's current position

PITCHER PARTNERS

which concludes that limited or few changes are required to the portfolio. It creates an environment where an adviser may recommend changes to enable them to justify the fee.

During a market downturn, such as the GFC, the adviser may have to significantly increase their workload – allowing them to charge greater fees at a time that the client portfolio is falling. This exacerbates the portfolio leakage and may result in a strained relationship between the client and adviser. A client may not be willing to approach their adviser for work because of the cost involved. Opportunities may be missed as a result. A fixed fee or asset-based fee arrangement may be more acceptable to the client because the upfront fees are much less. Market volatility may be better for a client under an asset-based fee arrangement.

An asset-based fee may mean that the adviser benefits greatly during the times of stable and positive returns, however, so too will the client. An argument might be put forward that this is not in the client's best interest and that during these times a fixed fee or time-based fee might be cheaper for the client. Retail clients may also be subsidised under these fee arrangements as the larger clients can pay a higher fee (depending on how the fee is structured) even though the costs of administration are similar. A larger portfolio does not necessarily translate into more work.

However, under a fixed fee or fee for service (e.g. hourly rate) arrangement, the costs associated with onboarding the client and preparing the initial statement of advice are brought forward and can result in much higher initial costs to the client. These can be so extensive that clients are not prepared to proceed (or pay) – particularly as the client sees little benefit in the onboarding process and associated compliance costs. An asset-based fee arrangement will generally amortise the costs of onboarding the client over several year and therefore the adviser is incentivised to develop a strong lasting relationship with their client. In addition, adviser recommendations and market outcomes are more aligned to the client – an adviser is incentivised to achieve stronger investment outcomes in both rising and falling markets.

The assumption that an asset-based fee is not good for a client does not take into consideration the many variables that might be built into a portfolio and the fee structure. What if the fees automatically adjust depending on the portfolio or investment value? What if certain investments, such as cash, are excluded from or adjusted for in the fees? What if the asset -based fee structure adjusts for the types of investments (e.g. less for managed funds or ETFs)? What if the asset-based fee adjusts for the frequency of meetings? What if fees are charged on a family basis and therefore the smaller client entities benefit from being associated with a larger portfolio? To simply conclude that an asset-based fee is not aligned with the client's best interests may be incorrect.

Our point is that there are many elements at play when deciding what fee structure is appropriate for each client. The adviser should be able to retain the flexibility to determine what works best.

For Pitcher Partners Investment Services Pty Ltd, this became very evident during the Global Financial Crisis (GFC). Because of our flexible 'asset-based' fee structure (we do not charge on cash and equivalent and direct property), the revenues for the licensee fell significantly at a time that our workloads greatly increased. Our fees fell by a higher percentage than the portfolio losses as we recommended our clients increase their cash position. This was in the client's best interest and won a great deal of loyalty from our clients and was and remains a significant factor in winning new clients today. Our clients were and remain highly supportive of our fee structure. At the time, a time-based or fixed fee arrangement would not have been in the best interest of our clients. This was recognised and appreciated by our clients.

We believe that APESB need to look at adviser remuneration through a different lens. We believe that the core principles of any fee structure, regardless of whether the client is wholesale or retail, must be as follows:

- The fee arrangement must be in the client's best interest;
- All fees must be collected in accordance with the law;
- All fees must be transparent and appropriately disclosed to the client;

- The fees must be accepted by the client and the client must be able to opt-out of the fee structure at any time; and
- Fees must not be collected when no service is provided.

We request that APESB give thought to developing core principles in place of a ban on asset-based fees.

We also appeal to the APESB to consider the broader competitive landscape when considering this matter. It may not be in the best interests of the Members or our clients to be forced down a path that regulators, industry and consumers do not seek or support.

5. APES 230 requires Members to obtain their clients' '*Informed Consent*' in respect of asset-based fees and third party payments, but not for fee for service. If Informed Consent is required for fee for service arrangements in APES 230:

   a) Are there any new systems, processes and/or policies that Members would need to implement?
   b) What are the challenges, if any, that Members consider would result from implementing these changes?
   c) Would the inclusion of a template in APES 230 which includes matters to be disclosed to clients to obtain Informed Consent for remuneration be useful for Members?

All Members are obligated under APES 305: Terms of Engagement to issue engagement letters and these engagement letters should include the 'Fees and billing arrangements' (paragraph 4.8) and 'Confirmation by the Client' (paragraph 4.10).

We therefore don't understand why it would be necessary for an adviser to obtain or beneficial for a client to give Informed Consent for fee for service arrangements. Why should this obligation exist for Financial Planning Advice but not all other Member services charged on a fee for service basis?

One of the challenges with a time-based fee for service model is determining in advance exactly what the fee will be. Would the advisor need to obtain Informed Consent each time a client requests assistance? How does an adviser obtain Informed Consent for annual reviews of portfolios when the time commitment is unknown in advance? What happens if there is a subsequent fee dispute – can the consent be withdrawn? We believe that from a practical commercial position, obtaining Informed Consent for fee for service arrangements would become very time consuming and challenging. It could become a disincentive to move down this path and may place Members at a competitive disadvantage.

We do not recommend that Informed Consent should be required for fee for service arrangements.

6. The Financial Services Royal Commission recommended that 'hawking' (unsolicited offer or sale) of superannuation and insurance products should be banned (recommendations 3.4 and 4.1):

   a) Does the requirement that Members' marketing or promotional activities must not bring the profession into disrepute adequately prevent unsolicited offers or sales in practice?
   b) If not, are there other mechanisms that could be put in place to prevent unsolicited offer or sale of financial products?

PITCHER PARTNERS

All recommendations tabled by the Financial Services Royal Commission are likely to be enacted. We therefore expect that these additional 'hawking' limitations will extend the existing absolute ban for sellers of securities and managed funds to superannuation and insurance products. These are likely to continue to be limited to retail clients as per the existing anti-hawking provisions.

The hawking prohibitions apply only to unsolicited telephone calls and meetings. They do not apply to unsolicited communications such as emails, letters, and media advertisements.

It may be possible to expand the hawking prohibitions to Financial Planning Services, however we are unsure whether this is necessary.

7. If APES 230 extended the concept of Informed Consent to the Terms of Engagement and the provision of the Financial Planning Advice, what are the challenges, if any, that Members consider would result from implementing these changes?

As raised at point 5 above, all Members are obligated under APES 305: Terms of Engagement to issue engagement letters and these engagement letters should include 'Confirmation by the Client' (paragraph 4.10).

Why should a greater obligation exist for Financial Planning Advice than it does for other services provided by Members? We are concerned that points 5 and 7 create a sense of distrust of Members by APESB and that APES 230 could be seen to actively discriminate against the providers of Financial Planning Advice.

8. APES 230 currently allows soft dollar (non-monetary) benefits up to a cap of $300, which is consistent with the *Corporations Act 2001* requirements. Should the cap remain?

The cap of $300 is very small and has not increased since 2001. We believe this cap remains appropriate.

9. Do you consider there are sufficient protections in APES 230, in relation to debt and gearing around asset-based fees for wholesale clients?

While we agree with the intent of APES 230 in respect of life insurance, other risk contracts and the procurement of loans, we believe that paragraph 9.3 of APES 230 is too restrictive and limits the Member's ability to establish a sensible commercial arrangement with clients. Where a Member elects to charge a professional fee on a Fee for Service basis, the Member should be able to offset upfront and trail commissions (which continue to be paid by the loan providers) against the agreed fee. It is not commercially sensible to, for example, rebate $8,000 to the client and then immediately issue an invoice of $5,000. The Member should be able to issue an invoice (stamped as paid) for the $5,000 and should then rebate the additional $3,000 to the client. The words "shall fully rebate" does not contemplate this sensible commercial arrangement.

Clients do not understand the logic of receiving a full rebate which is accompanied by an invoice that requires that all or part of the rebated funds are paid back to the Member.

We request that 9.3 is amended to accommodate a fee offset against Third Party Payments.

10. Are there any further reforms, issues or ideas that you believe the APESB should

PITCHER PARTNERS

consider in APES 230 in order to protect consumers who receive financial advice from a Member?

No.

We thank you for the opportunity to consider the Consultation Paper. We welcome any opportunity to further discuss any of our opinions or points that we have raised in our response to the Consultation Paper.

If you have any questions in relation to our response, please contact Geoff Gray directly on (03) 8610 5363 or via email at geoff.gray@pitcher.com.au.

Yours sincerely

A D STANLEY
Executive Director and Representative
adam.stanley@pitcher.com.au

G J GRAY
Chief Risk and Compliance Officer
geoff.gray@pitcher.com.au