

AGENDA PAPER

Item Number: 7
Date of Meeting: 18 February 2019
Subject: Update on the Royal Commission & impact on Financial Services

Action Required For Discussion For Noting For Information

Purpose

To provide the Board with an update on the key matters raised by the Royal Commission in the context of financial planning services.

Background

APESB issued APES 230 *Financial Planning Services* (APES 230) in April 2013, with an effective date of 1 July 2014, apart from the sections relating to remuneration which became effective on 1 July 2015.

In December 2017, the Australian Government appointed The Honourable Kenneth Hayne AC QC to conduct a Royal Commission into misconduct in the banking, superannuation and financial services industry in Australia.

The Royal Commission was tasked with inquiring whether conduct by financial services entities falls below community standards and expectations and whether the conduct amounts to misconduct. The Commission considered the root cause of any misconduct, the adequacy of relevant laws, policies, and self-regulation.

The Board requested at the June 2018 Board Meeting that Technical Staff keep a watching brief over the developments of the Royal Commission. This Agenda Paper outlines the developments since the December 2018 Board Meeting.

The Scope of the Royal Commission

The Royal Commission considered a broad range of matters in relation to the financial services industry. As part of completing the inquiry, the Commissioner has been conducting public hearings which focus on specific aspects of the financial services industry. The

scheduled public hearings, including the focus of each hearing and the case studies discussed, are set out in Table 1 below.

Table 1: Summary of the Royal Commission Public Hearings

| Public Hearing | Focus | Case Studies |
|--|---|---|
| Note: Rounds 1-4 were covered by Agenda Item 10 of the June 2018 Board Meeting. | | |
| Note: Round 5 was covered by Agenda Item 2 of the September 2018 Board Meeting. | | |
| Note: Round 6 was covered by Agenda Item 2 of the December 2018 Board Meeting. | | |
| Round 7 (19 - 23, 26 - 30 November 2018) | Policy questions The seventh round of public hearings focussed on the causes of misconduct by financial services entities, and on possible responses (including regulatory reform). | <ul style="list-style-type: none"> • Causes of misconduct • Possible responses (including regulatory reform) • The role of ASIC and APRA |

Refer to Agenda Item 7 (a) for a summary on Round 7 of the Royal Commission.

Matters for Consideration

(a) Final Report

The final report of the Royal Commission was released to the public on 4th February 2019. The report highlights the gravity of the misconduct that had occurred in the financial services industry, reinforces the need for underlying principles and general rules to govern conduct of the identified financial services entities, and includes 76 recommendations to prevent misconduct from reoccurring.

The report states that the primary responsibility for misconduct in the financial services industry lies with the entities concerned, and the Boards and senior management who manage and control those entities.

Four key observations were made by the Commissioner about the conduct reviewed:

- i.) **Misconduct was driven by the pursuit of profit and personal gain.** Sales became the focus and providing a service to customers was relegated to second place.
- ii.) **Entities and individuals acted in the way they did because they could.** Entities set out terms on which they would deal, and consumers did not have the power to negotiate terms, or had little detailed knowledge, or understanding of the transaction.
- iii.) **The conflict between duty and interest was seldom able to be managed.** Consumers often dealt with a financial services entity through an intermediary who they thought would act in their best interest. However, when the intermediary was paid by the provider of the service of product, the intermediary is more likely to act in the provider's interests or in their own interests.
- iv.) **Too often financial services entities that broke the law were not held to account.** To deter misconduct there needs to be the belief that the misconduct will be detected, denounced and justly punished. Paying compensation does not deter

misconduct that yields profits, and wrongdoing is not denounced by issuing a media release.

Underlying principles to guide conduct

In the final report, Commissioner Hayne lists six underlying principles enshrined in law that should be used to guide conduct of individuals and entities in the financial services industry:

- Obey the law;
- Do not mislead or deceive;
- Act fairly;
- Provide services that are fit for purpose;
- Deliver services with reasonable care and skill; and
- When acting for another, act in the best interests of that other.

These fundamental precepts are reflected in existing law but in a piecemeal way.

General rules for the financial services industry

Based on the underlying principles to guide conduct, Commissioner Haynes outlines the following general rules for the industry:

- The law must be applied and its application enforced;
- Industry codes should be approved under statute and breach of key promises made to customers in the codes should be a breach of statute;
- No financial product should be 'hawked' to retail clients;
- Intermediaries should act only on behalf of, and in the interests of, the party who pays the intermediary;
- Exceptions to the ban on conflicted remuneration should be eliminated; and
- Culture and governance practices (including remuneration arrangements) both in the industry generally and in individual entities, must focus on non-financial risk, as well as financial risk.

Recommendations

The final report includes 76 recommendations that aim to:

- simplify the law so that its intent is met;
- eliminate or remove conflicts of interest and conflicts between duty and interest;
- improve the effectiveness and operations of the regulators and increase compliance with the law;
- improve the culture, governance and remuneration of entities; and
- increase protections to consumers.

Both sides of government have committed to implementing most recommendations, including each of those recommended in respect of financial planning services.

The final report of the Royal Commission is available [here](#).

Refer to Agenda Item 7(b) for a high level summary of the recommendations (as reported in the Australian Financial Review on 5 February 2019).

Accounting firms and others have prepared high level analysis on the key recommendations and impacts of the Hayne Royal Commission. An example is the summary prepared by Deloitte titled *Culture, Customer, Purpose: Key Recommendations and Impacts from the Hayne Royal Commission* which is available on their [website](#).

Chartered Accountants Australia and New Zealand have also released a report 'Banking Royal Commission Impact Report: How the Banking Royal Commission affects CAs' which is available on their [website](#).

(b) Summary of APES 230 (Issued April 2013)

APES 230 was issued in April 2013 and sets out professional and ethical obligations in relation to financial planning services performed by Members of the professional bodies.

Scope of APES 230

The standard defined Financial Planning Advice as :

'...advice in respect of a Client's personal financial affairs specifically related to wealth management, retirement planning, estate planning, risk management and related advice, including:

- a) advice on financial products such as shares, managed funds, superannuation, master funds, wrap accounts, margin lending facilities and life insurance carried out pursuant to an Australian Financial Services Licence;
- b) advice and dealing in financial products as defined in section 766C of the *Corporations Act 2001*;
- 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).'

This definition makes the scope of APES 230 broader than the Future of Financial Advice (FOFA) legislation relevant to financial planning advice, in that it applies to activities such as mortgage broking and extends to wholesale clients which are not subject to FOFA.

Best Interest Duty

The existing APES 230 extended the Bests Interest Duty in FOFA to all clients and financial planning services, including services provided under the *National Consumer Credit Protection Act 2009* or services provided under any other legislation or regulations such as Private Health Insurance. This specific recommendation in the Hayne Royal Commission report is already reflected in APES 230.

Professional Fees

In relation to professional fees charged for the provision of Financial Planning Advice, APES 230 permits Members to either:

- (a) charge Clients on a Fee for Service basis; or
- (b) charge Clients a fee based on funds under management provided that the following safeguards are applied:
 - obtaining written Informed Consent from the Client prior to commencement of the Financial Planning Service;
 - making an annual disclosure to the Client; and
 - thereafter obtaining written consent from the Client on a biannual basis.

Informed Consent requires a higher standard than simple disclosure and requires that the client has a clear appreciation and understanding of the relevant facts in relation to the charging for services, as well as the implications of what the client is agreeing to. The accountant must also form a view about the level of understanding of his or her client.

Third Party Payments (including commissions)

In relation to third party payment, APES 230 permit two alternative remuneration methods. Members may either:

- (a) charge Clients on a Fee for Service basis; or
- (b) when the Member is to receive Third Party Payments, apply the following safeguards:
 - obtaining written Informed Consent from the Client prior to commencement of the Financial Planning Service;
 - disclosing three comparative quotes where available;
 - making annual disclosures to the Client on the estimated and actual amount of Third Party Payments received; and
 - where applicable, disclosing to the Client the impact of any proposed changes to existing life insurance and other risk contracts and loans.

At the time of issuing APES 230 the Board did state that their strong preference is for accountants to be remunerated on a fee for service basis as defined in APES 230 to minimise the remuneration driven conflicts of interest.

Further information on the key concepts within APES 230 are set out in the Basis for Conclusions issued with the release of the standard in 2013 (refer to Agenda Item 7(c)).

(c) Royal Commission recommendations specific to Financial Advice

The final report includes ten recommendations specific to financial advice which aim to address three key issues connected to the provision of financial advice:

- Fees for no service;
- The provision of poor advice which has left clients worse off; and
- The fragmented and ineffective disciplinary system for financial advisers.

Technical Staff have performed a preliminary review of the ten specific financial advice recommendations to determine any potential impacts on APES 230 *Financial Planning Services* (APES 230). This preliminary analysis is set out in the table below:

| Recommendations | | Potential impact on APES 230 |
|------------------------------|--|--|
| Fees for no service | | |
| 2.1 | <p>Annual renewal and payment</p> <p>The law should be amended to provide that ongoing fee arrangements (whenever made):</p> <ul style="list-style-type: none"> • must be renewed annually by the client; • must record in writing each year the services that the client will be entitled to receive and the total of the fees that are to be charged; and • may neither permit nor require payment of fees from any account held for or on behalf of the client except on the client's express written authority to the entity that conducts that account given at, or immediately after, the latest renewal of the ongoing fee arrangement. | <ul style="list-style-type: none"> • Section 5 <i>Terms of the Financial Planning Service</i> — update to include reference to annual agreement & services provided; • Section 7 <i>Client's information, monies and other property</i> — need for express written authority to withdraw fees • Section 8 <i>Professional Fees</i> — currently specifies biennial basis for obtaining consent but will need to be updated to refer to annual consent being required. Members are currently required to disclose to their Clients the amount of fees annually. |
| Conflicts of Interest | | |
| 2.2 | <p>Disclosure of lack of independence</p> <p>The law should be amended to require that a financial adviser who would contravene section 923A of the <i>Corporations Act</i> by assuming or using any of the restricted words or expressions identified in section 923A(5) (including 'independent', 'impartial' and 'unbiased') must, before providing personal advice to a retail client, give to the client a written statement (in or to the effect of a form to be prescribed) explaining simply and concisely why the adviser is not independent, impartial and unbiased.</p> | <p>Section 4 <i>Professional Independence</i> — a Member is required to disclose any effect on the Member's objectivity and professional independence. However, this may need to be amended to specify a written statement must be provided (not just the need to disclose)</p> |
| 2.3 | <p>Review of measures to improve the quality of advice</p> <p>In three years' time, there should be a review by Government in consultation with ASIC of the effectiveness of measures that have been implemented by the Government, regulators and financial services entities to improve the quality of financial advice. The review should preferably be completed by 30 June 2022, but no later than 31 December 2022.</p> <p>Among other things, that review should consider whether it is necessary to retain the 'safe harbour' provision in section 961B(2) of the <i>Corporations Act</i>. Unless there is a clear justification for retaining that provision, it should be repealed.</p> | <p>No specific change noted at this stage but will need to monitor any changes that could impact the definition of 'Best Interests of the Client'.</p> |

| Recommendations | | Potential impact on APES 230 |
|--------------------------------|---|--|
| 2.4 | <p>Grandfathered commissions</p> <p>Grandfathering provisions for conflicted remuneration should be repealed as soon as is reasonably practicable.</p> | Section 9 <i>Third Party Payments</i> — depending on the changes implemented in law, this section will need to be amended, in particular paragraphs 9.3 and 9.4. |
| 2.5 | <p>Life risk insurance commissions</p> <p>When ASIC conducts its review of conflicted remuneration relating to life risk insurance products and the operation of the ASIC Corporations (Life Insurance Commissions) Instrument 2017/510, ASIC should consider further reducing the cap on commissions in respect of life risk insurance products. Unless there is a clear justification for retaining those commissions, the cap should ultimately be reduced to zero.</p> | Section 9 <i>Third Party Payments</i> — depending on the changes implemented in law, this section will need to be amended, in particular paragraphs 9.2, 9.3 and 9.4. |
| 2.6 | <p>General insurance and consumer credit insurance commissions</p> <p>The review referred to in Recommendation 2.3 should also consider whether each remaining exemption to the ban on conflicted remuneration remains justified, including:</p> <ul style="list-style-type: none"> • the exemptions for general insurance products and consumer credit insurance products; and • the exemptions for non-monetary benefits set out in section 963C of the <i>Corporations Act</i>. | <p>Where the advice is within the scope of personal Financial Planning Advice then APES 230 will include these activities within its scope.</p> <p>Section 9 <i>Third Party Payments</i> and Section 10 <i>Soft Dollar Benefits</i> — if the exemptions are removed, this may impact the definition of Soft Dollar Benefits, paragraphs 9.2 to 9.4, and paragraphs 10.2 to 10.4.</p> |
| Professional discipline | | |
| 2.7 | <p>Reference checking and information sharing</p> <p>All AFSL holders should be required, as a condition of their licence, to give effect to reference checking and information-sharing protocols for financial advisers, to the same effect as now provided by the ABA in its 'Financial Advice – Recruitment and Termination Reference Checking and Information Sharing Protocol'.</p> | No specific impact from a professional standards perspective. |
| 2.8 | <p>Reporting compliance concerns</p> <p>All AFSL holders should be required, as a condition of their licence, to report 'serious compliance concerns' about individual financial advisers to ASIC on a quarterly basis.</p> | No specific impact from a professional standards perspective. Opportunity to provide guidance as part of the Confidentiality obligations of the Member. |

| Recommendations | | Potential impact on APES 230 |
|-----------------|---|---|
| 2.9 | <p>Misconduct by financial advisers</p> <p>All AFSL holders should be required, as a condition of their licence, to take the following steps when they detect that a financial adviser has engaged in misconduct in respect of financial advice given to a retail client (whether by giving inappropriate advice or otherwise):</p> <ul style="list-style-type: none"> • make whatever inquiries are reasonably necessary to determine the nature and full extent of the adviser's misconduct; and • where there is sufficient information to suggest that an adviser has engaged in misconduct, tell affected clients and remediate those clients promptly. | <p>No specific impact from a professional standards perspective. Need to consider whether additional requirement or guidance is required in APES 230.</p> |
| 2.10 | <p>A new disciplinary system</p> <p>The law should be amended to establish a new disciplinary system for financial advisers that:</p> <ul style="list-style-type: none"> • requires all financial advisers who provide personal financial advice to retail clients to be registered; • provides for a single, central, disciplinary body; • requires AFSL holders to report 'serious compliance concerns' to the disciplinary body; and • allows clients and other stakeholders to report information about the conduct of financial advisers to the disciplinary body. | <p>No specific impact from a professional standards perspective.</p> <p>If a NOCLAR provision is included in APES 230 there is the potential to include an additional guidance paragraph in relation to the disclosure of matters to the disciplinary body.</p> |

From an initial Technical Staff review it appears that APES 230 (Issued in 2013) has held up well against the key recommendations in the Royal Commission's final report, and in some cases already incorporate the recommended approaches in respect of personal Financial Planning Advice.

Way forward

Technical Staff will continue to monitor the approach by the Government to the implementation of the recommendations in the Royal Commission. Technical Staff will also consider these recommendations in the review of APES 230 that is being performed as part of the project to revise all APESB pronouncements to align with the restructured *Code of Ethics for Professional Accountants (including Independence Standards)*.

Staff Recommendation

The Board note and discuss the update on the key matters raised at the Royal Commission in the context of the financial planning industry, as well as the potential impact of the Royal Commission's final report on APES 230.

Material Presented

Agenda Item 7(a): Summary of Round 7 of the Royal Commission
Agenda Item 7(b): AFR article, *Recommendations*, 5 February 2019
Agenda Item 7(c): APES 230 *Financial Planning Services - Basis for Conclusions* (2013)

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