9 November 2012

Ms Kate Spargo
Accounting Professional & Ethical Standards Board Limited
Level 7, 600 Bourke St
MELBOURNE VIC 3000
AUSTRALIA

By email: sub@apesb.org.au

Dear Kate

Proposed Standard: APES 230 Financial Planning Services

CPA Australia and the Institute of Chartered Accountants Australia (the Institute) welcome the opportunity to comment on the Accounting Professional and Ethical Standards Board (APESB) proposed standard APES 230 Financial Planning Services.

CPA Australia and the Institute represent over 200,000 professional accountants. Our members work in diverse roles across public practice, commerce, industry, government and academia in Australia and internationally. In developing our submission we have consulted with both our members and other relevant stakeholders.

APES 230, like all standards issued by the APESB, seeks to promote the public interest.

We believe that our members are committed to providing quality advice which is in the public interest.

It is our view that transparency and disclosure are fundamental key tenets of a professional client relationship, notwithstanding the form of remuneration (or its calculation or method of payment) agreed between the adviser and client.

In recognition of this, and in support of the underlying principles in the draft standard, we believe there are aspects of what is proposed that the APESB should re-consider. One of our concerns is that clients may not seek professional advice simply because of the impact of the proposed remuneration model prescribed in this exposure draft.

We believe the broader context in which this proposed standard is being developed is characterised by significant change since the initial review of APS 12 in 2008 and the commencement of the Future of Financial Advice (FoFA) reform agenda in 2009. As the APESB is aware many aspects of the FoFA reforms are still being developed and clarified in the lead up to its commencement in 2013.

One of the cornerstone elements of the FoFA reforms is the ‘best interests’ obligation and related duties. These impose a legal requirement on financial planners to act in the best interests of their clients from 1 July 2013, the same date the draft standard is proposed to commence.

The ability of the new 'best interests' obligation to meet ASIC's expectations and address potential conflicts of interest when providing advice is yet to be demonstrated. However, we believe it creates a powerful new legislative safeguard that has the potential to address self-interest threats; and this safeguard includes a disciplinary framework.

We believe there is an opportunity for the APESB to consider the adoption of additional safeguards (such as the introduction of an 'informed client consent' safeguard) that will address the APESB's concerns regarding the potential threats to compliance with the principles of the Code.

We strongly support the mandate of the APESB to operate in the public interest. Further, we have long supported fee-for-service as the preferred method of remuneration for the financial planning industry and as such, support the principles guiding the proposed standard APES 230.

CPA Australia and the Institute are strongly committed to upholding professionalism and the public interest. It is an ongoing journey that at times does require changes to behaviour and systems to ensure these objectives can continue to be achieved. The development of proposed standard APES 230 is no different. In the attached submission we have made several recommendations to amend the proposed standard in light of the impending introduction of FoFA reforms especially if they are supplemented by the adoption of the new safeguards which we have outlined in Part 2 of the submission. We clearly recognise that the successful implementation of the amended standard will still require our commitment to assist and educate members with the ongoing journey to uphold the public interest. It is this commitment that will continue to motivate the profession and ensure that consumers continue to receive quality advice that they can trust.

The submission has been structured in three parts:

- Part 1 – Summary of Recommendations
- Part 2 – Comments on Proposed Standard APES 230
- Appendix – Other Considerations.

If you have any questions regarding this submission, please do not hesitate to contact Keddie Waller (CPA Australia) at keddie.waller@cpaaustralia.com.au and Hugh Elvy (the Institute) at hugh.elvy@charteredaccountants.com.au.

Yours sincerely

Alex Malley
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Lee White
Chief Executive Officer
Institute of Chartered Accountants in Australia

PART 1 – SUMMARY OF RECOMMENDATIONS

1. **The APESB issues APES 230 commencing 1 July 2014 with the amendments outlined in the following recommendations. In 2017 the APESB assess the effectiveness of the new legislative safeguards (best interests obligation and related duties) implemented through the FoFA reforms to address self-interest threats and other disclosure safeguards.**

2. **The APESB continue with its formal annual review process for professional standards. It is recommended that no fundamental changes should be incorporated into APES 230 as part of these reviews until a final review and further consultation has been undertaken in 2017.**

3. **The wording of paragraphs 8.1 and 8.2 of the ED, which deal with Professional Fees, to be redrafted in a form consistent with what we have outlined in Section 3 of Part 2 of our submission.**

4. **Members are not banned from receiving commissions on insurance but are required to use the conceptual framework of the Code to identify, evaluate and address any threats created. To address perceived or potential conflicts of interest created by commissions the accounting profession works with the industry to develop and implement additional safeguards, such as:**
   - **disclosure of at least three comparative quotes when a recommendation is made**
   - **duty of disclosure around changing of insurers within certain timeframe of policy period; and**
   - **a mandated summary (short-form) disclosure statement of advice and fees.**

5. **Members are not banned from receiving commissions on lending products but are required to use the conceptual framework of the Code to identify, evaluate and address any threats created. To address perceived or potential conflicts of interest created by commissions the accounting profession works with the industry to develop and implement additional safeguards, such as a mandated summary (short-form) disclosure statement of advice and fees.**

6. **APES 230 introduces the additional obligation to obtain a client's informed consent (which is at a higher level than disclosure), before a commission, fee or other benefit can be received.**

7. **Section (c) is removed from the current definition of Financial Planning Advice to ensure Taxation Services are not unintentionally captured by APES 230.**

8. **Section (d) advice and services related to the procurement of loans and other borrowing arrangements, including credit activities provided pursuant to an Australian Credit Licence be removed from the definition of Financial Planning Advice.**

   OR

   APES 230 be redrafted to accurately reflect the scope of the advice covered by the standard and references applicable requirements under both the Corporations Act 2001 and the National Consumer Credit Protection Act 2009. In this instance, the title of the standard is amended to 'Financial planning and credit services' to also accurately reflect the scope of the standard and reflect industry terminology.

9. **To provide clarity over the intended scope of the standard, section (e) of Financial Planning Advice is removed until current regulatory reforms are progressed. This decision can then be reviewed post implementation.**

10. **Should recommendations one to five be adopted, we recommend the commencement date of the standard is amended to 1 July 2014.**

The adoption of these recommendations will address the issue of the standard applying retrospectively (i.e. to existing arrangements).

The above recommendations are further developed in our detailed submission which follows.

PART 2 – COMMENTS ON PROPOSED STANDARD APES 230

1. The financial planning industry

The financial planning industry is currently transitioning through the most significant regulatory changes since the introduction of the *Financial Services Reform* in 2001. These reforms require fundamental changes, made even more challenging by the fact that the industry is still recovering from the impact of the global financial crisis.

It is understood that the FoFA reforms will cost the industry millions of dollars to implement given the requirements for new systems, including new information technology platforms, to ensure ongoing compliance. Licensees owned by, or linked to, an institution will have access to adequate resources and be supported through this change. However, the potential cost and the uncertainty of future legislation during a period of slow economic recovery has resulted in some independent licensees, both small and large, merging with larger groups or institutions. One specific example for the accounting profession is the Commonwealth Bank's acquisition of Count Financial. It is understood that the uncertainty of the FoFA reforms following the global financial crisis was one of the catalysts for this decision.

The dominance of large dealer groups and institutions in the financial planning industry is well known. Statistics indicate that approximately 85% of financial planners are associated with a product manufacturer.[1] This dominance is set to continue as institutions openly seek further acquisition opportunities, including recent moves to purchase and align with accounting practices given the future removal of the accountants' licensing exemption to recommend a self managed superannuation fund.

What is of relevance and needs to be considered in the development of this standard is not that the majority of the industry is associated and aligned with product providers but the fact that all these groups have very similar structures, processes and systems making it extremely difficult to consider alternative business model structures.

Importantly members of the accounting profession did not develop the structure of this industry and at the practitioner level do not have the influence to change its current systems and structures.

Therefore, while we appreciate that the APESB has noted the FoFA reforms before releasing the revised APES 230 exposure draft, we believe the regulatory impact and associated structural changes and implications that will result from these reforms should be explored further.

Members in Public Practice and the licensing framework

The structure of accounting firms that provide financial planning services is significantly different to accounting firms that provide other accounting services.

The vast majority of our members working in public practice are licensed under another entity's Australian Financial Services License (AFSL), rather than holding their own AFSL. The reasons for operating under this business model include ease and simplicity, lower compliance cost and burden and access to business support and resources. This model provides members and firms with an effective business model to incorporate financial planning into their firms. It allows firms to concentrate on developing the business and client base and requires less time to be allocated to administrative and compliance issues.

Being licensed under another entity's licence requires members to adhere to their licensee's processes and systems, which extend to include remuneration models and designated platforms. Further, members are required to limit any product recommendations to an approved product list, necessary to maintain valid professional indemnity insurance cover.

Therefore, even though members may run their own public practice entity, they are in fact required to adhere to all requirements set by their licensee, which is likely to be either owned or linked to one of the five large industry institutions. This means they have little or no ability to influence any change in processes, systems or

[1] IBIS World Industry Report, Financial Planning and Investment Advice in Australia (K7515), 22 May 2009, p. 7.

product selection. (Note: Adherence to the licensees requirements is mandatory as the advice provided by the firm is ultimately the responsibility of the AFS licensee).

The consequence of the existing industry structure is that if APES 230 is implemented as currently drafted, and it does not have the support of the licensees (institutions), our members will be unlikely to comply with all of these requirements without having to in essence rebuild their practice.

In fact, it is our view that only members who hold their own AFS licence are likely to be able to comply with the proposed requirements of APES 230. This is evidenced by the fact that industry participants who have provided their support for APES 230 as drafted are primarily smaller independent practices. However, these practices are not representative of the industry. Members who do not hold their own licence would not currently comply with the proposed requirements of APES 230. For those members, the necessary investment to transition to new remuneration models proposed by APES 230 would pose a significant challenge.

2. The new regulatory framework (FoFA)

The environment in which financial planning advice will be provided from 1 July 2013 will be very different from the current environment and that which existed when the review of APS 12 commenced in 2008.

This change will be primarily driven by Division 2 – Best interests obligation, Part 7.7A of the *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012*. In his second reading, the Hon. Minister Bill Shorten, Minister for Financial Services and Superannuation stated that:

The best interests duty is a legislative requirement to ensure the processes and motivations of financial advisers are focused on what is best for their clients. It is true that this will ultimately lead to better advice in many cases, but first and foremost it is about regulating conflicts, not the intrinsic quality of the advice provided.

From 1 July 2013, the new legislation will mandate that a financial planner must act in the best interests of the client in relation to the advice. According to the Explanatory Memorandum to the legislation, the principle guiding the application of the best interests obligation is that meeting the objectives, financial situation and needs of the client must be the paramount consideration when providing advice.

Subdivision E of Division 2 introduces a further legislative obligation known as the ‘conflicts priority rule’, which requires that the provider of the advice must give priority to the client’s interests. This requires financial planners to give priority to the interests of the client in situations where the provider knows, or reasonably ought to know, there is a conflict between the interests of the client and the interests of a ‘related party’. A ‘related party’ includes:

- a financial planner
- an associate of the financial planner
- a licensee of whom the financial planner is a representative
- an associate of an AFS licensee of whom the financial planner is a representative
- an authorised representative who has authorised the advice provider to provide financial services (or a financial service) on behalf of an AFS licensee; or
- an associate of an authorised representative who has authorised the advice provider to provide financial services (or a financial service) on behalf of an AFS licensee.

Essentially this imposes a new legal obligation upon financial planners not to act to further their interests, or those of any related parties, over the client’s interests when giving the client personal advice.

Importantly, using information barriers to prevent a financial planner from becoming aware of any conflicting interests of a related party would be considered a breach of this obligation.

Together the provisions of Division 2 will implement the legislative framework for ensuring financial planners act in all circumstances in the best interests of the client. Failure to comply with these obligations may result

in a civil penalty against the financial planner or AFS licensee. Financial planners and their licensees may also be subject to administrative sanctions for breaching their obligations, for example, being banned from providing financial services for a period of time. Further, a client or ASIC, may take civil action for any loss or damage suffered as the result of a failure to comply with the best interests duty and related obligations.

The new legislation received Royal Assent in late June of this year. Consequently ASIC has only recently issued its draft guidance on how it intends to administer the new best interests obligation. It has stated that the new best interests duty and related obligations should lead to a higher quality of advice being provided compared with the standard of advice being provided under the current requirements of s945A and 945B.[2] Further, it expects that the processes financial planners follow in acting in the best interests of their client will result in the client being in a better position if the client acts on the advice provided.

Given that the best interests obligation is a new requirement, which will not become mandatory until 1 July 2013 we are yet to have the opportunity to consider how effective the new framework will be in addressing perceived and actual conflicts of interest when providing financial planning advice.

CPA Australia and the Institute believe that the new best interests obligation and related duties may provide an additional safeguard that addresses potential self interest threats to compliance with the fundamental principles of integrity, objectivity and professional competence and due care of the Code.

We are also of the opinion that these new legislative safeguards reduce threats to compliance with the fundamental principles and therefore suggest that the APESB considers the new legislative safeguards and allows an appropriate period in which to review their effectiveness.

Recommendations:

1. The APESB issues APES 230 commencing 1 July 2014 with the amendments outlined in the following recommendations. In 2017 the APESB formally assess the effectiveness of the new legislative safeguards (best interests obligation and related duties) implemented through the FoFA reforms to address self-interest threats and other disclosure safeguards.

2. The APESB continue with its formal annual review process for professional standards. It is recommended that no fundamental changes should be incorporated into APES 230 as part of these reviews until a final review and further consultation has been undertaken in 2017.

3. Asset Based Fees / Funds Under Management (FUM)

The APES 230 draft standard's Explanatory Memorandum (EM) states that asset based fees are based on the quantity of product sold or FUM which results in an actual or perceived conflict. This is based on the perspective that it is potentially in the member's best financial interest to sell more product to the client or to increase FUM, a more appropriate option for the client may be an alternative such as using funds to repay existing debt. Further, these volumes or quantity based sales incentives may not adequately take into account the client's financial objectives or risk appetite when purchasing financial products. Consequently, the APESB considers that this method of remuneration creates a self-interest threat to the fundamental ethical principles of integrity objectivity, and professional competence and due care.

Based on the consultation with stakeholders between June 2010 and August 2011, the APESB stated in the EM that it believes that there are no safeguards for these self-interest threats which could eliminate them or reduce them to an Acceptable Level. Consequently, the APESB proposed to prohibit percentage of asset based fees which are linked to FUM. (However, as drafted APES 230 does not prevent members from considering the amount of FUM a client has as one of the relevant factors to determining their professional fee.)

[2] ASIC Consultation Paper 182 *Future of Financial Advice: Best interests duty and related obligations – Update to RG 175*, p.5.

New legislative safeguard

Since the APESB reached its position the legislation which will implement the FoFA reforms has been passed by Parliament and received Royal Assent. CPA Australia and the Institute believe that the best interests obligation and related duties create a new legislative safeguard that has the potential to reduce the self-interest threats, identified by the APESB, to an Acceptable Level.

The general best interests obligation and supplementary provisions will establish a framework which will specifically require a financial planner to, among other things, base all judgments in advising a client on the client's relevant circumstances.

If, in considering the subject matter of the advice sought, it would be reasonable to consider recommending a financial product, the financial planner must conduct a reasonable investigation into the financial products that might achieve those objectives and meet the needs of the client.

Further, the new legislative 'conflicts priority rule' will mandate that, when giving the client personal advice, financial planners must give priority to the interests of the client and not act to further their interests, or those of any of their related parties.

ASIC stated that the following basic policy principles will be used for the best interests duty and related obligations:

a) the provisions are intended to enhance trust and confidence in the financial advice industry;
b) increased trust and confidence in the financial advice industry should lead to more consumers accessing financial advice;
c) the provisions should lead to a higher quality of advice being provided compared with the standard of advice being provided under s945A and 945B; and
d) if a client were to follow the advice, it is likely that this would leave them in a better position.

Importantly, ASIC has stated that the concept of leaving the client in a better position is not necessarily confined to a monetary improvement but can encompass such things as a person's preparedness for the future, susceptibility to risk or having access to certain product features or services. Leaving the client in a better position does not include improvements that are trivial or that have no value to the client, taking into account the subject matter of advice sought by the client.

While ASIC is still finalising its regulatory guidance, it provided the following examples of how these provisions will establish a framework to address conflicts such as those identified by the APESB in Consultation Paper 182 *Future of Financial Advice: Best interests duty and related obligations – Update to RG 175* (CP 182).

Example 1: Client seeking wealth accumulation advice

A client (33 years old) approaches a financial planner for advice on wealth accumulation strategies. The client recently received a promotion and has considerable surplus income. On assessment, the planner establishes that, because of the high level of income the client receives, they have limited ability to add more funds to superannuation through 'salary sacrifice' concessional contributions. The client's mortgage is significant, but manageable, given their current income and personal circumstances.

The advice provider provides recommendations to salary sacrifice up to the maximum limit for concessional contributions, and to use the surplus funds to repay the mortgage.

ASIC Commentary

Where personal advice is sought by a client who has surplus income, and is not seeking advice with a limited scope, **we are more likely to consider that the best interests duty has been complied with if there is evidence of non-product-specific strategies being considered by the advice provider, such as debt reduction or salary sacrifice**.

Example 2: Client receives a windfall

A client has received a substantial inheritance from a recently deceased aunt. The client is in their early 20s and completing their final year of university. They have no knowledge of financial matters and are seeking advice about how the inheritance should be applied to improve their financial position. The client has a small credit card debt and a HECS-HELP university fees debt, wants to upgrade their car and would like to buy a house within the next three to five years.

ASIC Commentary

It is implicit that the client is seeking advice about managing and repaying debt, managing expenses and how to save for future goals based on their circumstances.

These examples demonstrate that ASIC has a clear expectation that financial planners must consider non-product specific strategies when providing advice to demonstrate compliance with the best interests obligation, such as the repayment of debt.

Example 3: Related party products

An advice provider determines that it would be appropriate under s961G to recommend that their client acquire interests in one of two different managed investment schemes. These products are identical except that one product has slightly higher ongoing fees than the other product. The responsible entity of the product with the higher fees is a related party of the advice provider's AFS licensee.

ASIC Commentary

To comply with the conflicts priority rule, the advice provider should recommend that the client acquire interests in the managed investment scheme that has the lower ongoing fees. This is what an advice provider without a conflict of interest would do. **Of the two products, acquiring interests in the scheme with the lower ongoing fees prioritises the interests of the client over the interests of the related party of the advice provider.**

ASIC follows this example by stating that an advice provider cannot comply with the conflicts priority rule by merely disclosing a conflict of interest. Further, in some cases complying with the best interests duty and the 'appropriate advice' requirement will not be sufficient to comply with the conflicts priority rule.

The best interests obligation and related duties establish a new robust framework that will require financial planners to meet a higher threshold of compliance than ever before when providing financial planning advice. Meeting the objectives, financial situation and needs of the client must be the paramount consideration when providing advice. Further, conflicts of interest can no longer be merely disclosed, they must be addressed to ensure the client's interests are always given priority.

A financial planner will not be able to advise a client to invest in further investment products in order to increase the Member's FUM unless it can be demonstrated that it is in the best interests of the client, taking into account all of the client's relevant circumstances including their financial objectives and appetite for risk. Further, financial planners must ensure their recommendations also place the interests of the client ahead of their own interests and those of any related party.

CPA Australia and the Institute believe that the new legislative safeguards can be effective in eliminating or reducing any threats to compliance with the fundamental principles, that asset based fees may create.

Ban on asset-based fees on borrowed amounts

From 1 July 2013, as part of the FoFA reforms, where financial product advice is provided to a retail client financial planners will be banned from charging asset based fees on borrowed amounts.

The FoFA reforms are the government's response to the Parliamentary Joint Committee (PJC) on Corporations and Financial Services *Inquiry into financial products and services in Australia*, released November 2009. Of note, this inquiry did not recommend the banning of asset based fees on either ungeared or geared amounts. The reform was implemented by the government, which stated that the specific reason for this measure was to target any future conflicts of interest where a financial planner may be incentivised to

recommend leverage to increase funds under management and hence their fees. This statement was accompanied by the following quote from the PJC inquiry to demonstrate the basis for this decision:

'..for at least a sub-set of Storm's investment clients – the advice to engage in aggressive leveraged investment strategy was clearly inappropriate.'[3]

The government's policy to ban asset based fees on leveraged amounts aims to ensure the specific model used by Storm Financial to aggressively gear clients could not be used again to increase fees that could be charged, and not to ban the remuneration model in principle. This decision by government acknowledges the devastating impact such gearing strategies can have on investors when recommended inappropriately.

Professional Fees

Paragraph 8.3 of the draft standard outlines the range of factors that members may consider in determining the professional fee for a Financial Planning Service and provides members with the flexibility to determine the appropriate fee.

Importantly, the factors outlined in paragraph 8.3 are the same factors currently used by members to determine their remuneration models. Members typically then convert this into a percentage model, that is scaled depending on the level of FUM invested, recognising the value of FUM is one of the factors that determines their professional fee.

If the potential self interest threats cited by the APESB in the EM to the draft standard are reduced to an acceptable level, which we believe the best interests duty and related obligations will have the potential to do, then whether a flat fee, hourly fee or percentage of assets fee is used to determine the professional fee is immaterial. As are the consequences of such fee models, which importantly do not pose self-interest threats, for example the fact that an ongoing fee may fluctuate over time.

This is also consistent with paragraph 240.1 of the Code which permits a member in Public Practice to quote a fee it deems is appropriate, provided that any threats to compliance with the fundamental principles created by the fees quoted are evaluated and safeguards applied where necessary to eliminate or reduce them to an acceptable level. Examples of such safeguards include making the client aware of the terms of engagement, and in particular, the basis on which fees are charged and which services are covered by the quoted fee. Members who provide financial planning services use these safeguards.

We therefore believe that fee setting considerations should be decided by members provided they comply with section 240 of the Code.

Further, we believe the wording in the standard could be revised to achieve an appropriate outcome. For example, wording can be included that emphasises that a range of elements (including funds under management) have been considered in the calculation of the fee and that the fee has not been calculated on only one element.

We propose the following wording for paragraphs 8.1 to 8.2:

8. Professional fees

8.1 A Member in Public Practice shall determine and charge a professional fee for providing a Financial Planning Service to a Client that takes into account a range of factors. This may be expressed or collected as a percentage of the value of the Client's assets or funds under management (or any component of, or changes in such values).

8.2 Factors that a Member in Public Practice shall consider in determining the professional fee for a Financial Planning Service include the nature and complexity of the Financial Planning Service, the scope and scale of the service provided, the level of experience and expertise of the Member and the Member's staff, the degree of responsibility applicable to the work, inherent risks associated with the

[3] Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into Financial Products and Services in Australia, paragraph 3.37, page 22.

service, the time spent on the Financial Planning Service and the value of the Client's assets or funds under management.

Recommendation:

3. The wording of paragraphs 8.1 and 8.2 of the ED, which deal with Professional Fees, to be redrafted in a form consistent with what we have outlined in Section 3 of Part 2 of our submission.

4. Commissions (insurance and mortgage broking)

Commission remuneration models are currently entrenched in the insurance and mortgage broking industries. These industries are dominated by the major financial institutions and insurance companies. Any changes to remuneration models and industry norms will require participation from these stakeholders.

We also emphasise that members did not develop the structure of the current system and as practitioners do not control its structure.

However, we believe that a combination of existing and new legislative safeguards could adequately address the self-interest threat to the fundamental principles, which the APESB have identified as arising from conflicted remuneration models, such as commissions.

Insurance – new legislative safeguard

As previously outlined, the new general best interests obligation and supplementary provisions will establish a framework which will specifically require a financial planner to, among other things, base all judgments in advising a client, on the client's relevant circumstances.

If, in considering the subject matter of the advice sought, it would be reasonable to consider recommending a financial product, the financial planner must conduct a reasonable investigation into the financial products that might achieve the client's objectives and meet their needs.

Further, the 'conflicts priority' rule will mandate that financial planners must give priority to the interests of the client and will not not act to further their interests, or those of any related parties, over the client's interests.

The conflicts priority rule means[4]:

a) a financial planner must not recommend a product or service of a related party to create extra revenue for themselves, their AFS licensee or the related party, where additional benefits for the client cannot be demonstrated;

b) a financial planner must not 'over-service' the client to generate more remuneration for themselves or one of their related parties. This means that the advice provider must provide a level of service commensurate with the client's needs. For example, they must not recommend an unduly complex strategy if the client is unlikely to seek ongoing advice; and

c) a financial planner must recommend non-financial product solutions relevant to the client's situation, where appropriate, even if this means the client is less likely to need financial advice in the future (e.g. advice on debt reduction, estate planning and/or Centrelink benefits).

While the conflicts priority rule does not prohibit an advice provider from accepting remuneration from a source other than the client, for example a commission, it does prohibit financial planners from accepting certain types of remuneration which could reasonably influence the financial product advice they give or the financial products they recommend to clients.

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[4] ASIC Consultation Paper 182 *Future of Financial Advice: Best interests duty and related obligations – Update to* p.66 RG175.A148

Further, if a financial planner gave priority to maximising the non-client source of remuneration over the interests of the client, they would be in breach of the ‘conflicts priority’ rule.

ASIC provided the following example in CP 182 of how these provisions will establish a framework to address the potential of recommending a product to receive a higher commission.

Example 4: Remuneration conflicts – life insurance commissions

An advice provider is providing a client with personal advice on acquiring life insurance. They recommend that the client acquire the life insurance product that pays the greatest commission to the advice provider and their AFS licensee. They do not consider the features of different life insurance products in light of the client’s objectives, financial situation and needs.

ASIC Commentary

In this situation, we consider that s961J has been breached. The advice provider has given priority to maximising the non-client source of remuneration over the interests of the client.

CPA Australia and the Institute believe that the best interests obligation and related duties are appropriate available safeguards that can be applied to eliminate, or reduce to an acceptable level, the threats that the receipt of commissions may create.

Insurance – adoption of new safeguards

In addition to the existing and new legislative safeguards, CPA Australia and the Institute believe there are opportunities to develop further safeguards in addition to the best interests obligation and related duties, to address any threats to compliance with the fundamental principles of the Code.

Additional safeguards that could be considered and developed include:

- disclosure of at least three comparative quotes when a recommendation is made, which will enable a client to compare advice and information
- duty of disclosure if there is a recommendation to change insurers within a certain policy period to address self-interest threats created by ‘churning’; and
- a mandated short form summary advice / disclosure statement to ensure the client has a clear understanding of the advice being provided and the associated cost.

These safeguards could be tailored to specifically address potential self-interest threats and ensure transparency of advice and any associated product recommendations. Further, CPA Australia and the Institute intend to work together with the industry to develop and implement these additional safeguards.

CPA Australia and the Institute believe the new legislative safeguards together with the proposed additional safeguards provide an appropriate framework of safeguards that could eliminate, or reduce to an acceptable level, the threats to compliance with the fundamental principles.

Recommendation:

4. Members are not banned from receiving commissions on insurance but are required to use the conceptual framework of the Code to identify, evaluate and address any threats created. To address perceived or potential conflicts of interest created by commissions the accounting profession works with the industry to develop and implement additional safeguards, such as:

- disclosure of at least three comparative quotes when a recommendation is made

- duty of disclosure around changing of insurers within certain timeframe of policy period; and

- a mandated summary (short-form) disclosure statement of advice and fees.

Mortgage broking – Existing legislative provisions

CPA Australia and the Institute believe that existing legislative provisions of the National Consumer Credit Protection Act (National Credit Act) and other lending requirements provide an existing framework that provides safeguards to address potential or perceived self-interest threats.

Members of the accounting profession cannot provide consumer credit advice unless they are licensed through holding their own Australian Credit Licence (ACL) or they are a credit representative of an ACL under the National Credit Act.
The National Credit Act requires an Australian Credit Licensee to have in place adequate arrangements to ensure that a client is not disadvantaged by any conflict of interest that may arise wholly or partly in relation to credit activities engaged by the licensee or representatives.[5]

To ensure compliance with this requirement, licensees must have in place adequate risk management systems that ensure the clear identification of all risks that may be faced and measures that are in place to keep those risks to an acceptable minimum.

ASIC expects the risk management system to[6]:

- be based on a structured and systematic process that takes into account your obligations under the National Credit Act;
- identify and evaluate risks faced by your business, focusing on risks that adversely affect consumers or market integrity (this includes risks of non-compliance with the credit legislation as relevant);
- establish and maintain controls designed to manage or mitigate those risks; and
- fully implement and monitor those controls to ensure they are effective.

ASIC has stated that these arrangements would need to ensure that staff or representatives of the licensee are not favouring the achievement of volume targets over the interests of the client. These may include compliance procedures designed to ensure that the licensee does not suggest a credit contract that is unsuitable for the consumer so that consumers are not disadvantaged by the incentive offered to the licensee who is providing the credit assistance.

In addition to the legislative safeguards, CPA Australia and the Institute believe there are further opportunities to develop additional safeguards such as a mandated short form summary advice / disclosure statement to ensure the client has a clear understanding of the advice being provided and the associated cost.

CPA Australia and the Institute believe these measures and the general obligation credit advisers have to ensure their client is not disadvantaged by any conflict of interest provides an appropriate safeguard that can reduce threats to compliance with the fundamental principles to an acceptable level.

Recommendation:

5. Members are not banned from receiving commissions on lending products but are required to use the conceptual framework of the Code to identify, evaluate and address any threats created. To address perceived or potential conflicts of interest created by commissions the accounting profession works with the industry to develop and implement additional safeguards, such as a mandated summary (short-form) disclosure statement of advice and fees.

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[5] ASIC Regulatory Guide 205: *Credit licensing: General conduct obligations*, paragraph 205.47
[6] ibid paragraph 205.74, p.20

5. Implementation of new safeguards – informed consent

CPA Australia and the Institute recommend the Board incorporate a further obligation beyond the mandatory disclosure obligations of paragraph AUST240.7.1 of the Code where a Member in Public Practice receives a commission, requiring the Member to seek the informed consent of the client in order to actually receive the commission, fee or other benefit.

This is a higher level of agreement with the client than disclosure only.
The requirement to seek "informed consent" from a client is already mandated in some overseas jurisdictions such as in the UK, where the details of informed consent are outlined in the Chartered Accountants Regulatory Board's Investment Business Regulations - Investment Intermediaries Act 1995 GUIDANCE (Updated 1 July 2011). Section 3.22 (1) of this Guide outlines the requirements for informed consent when receiving commissions:

'*A firm may keep commission or other benefit received from persons other than the client if this is disclosed and authorised by the client.'*

Section 3.22 (2) then requires the firm to either:

- account to the *client* for any commission, for example by paying it to the *client* or by deducting it from the fees chargeable to the *client* and showing the deduction on the bill; or
- get the *client's* agreement to keep the commission.

Further guidance can be provided to demonstrate how the engagement letter could be worded to ensure it contains clear wording in order for the firm to be allowed to keep any commission, fee or benefit.

Implementing a requirement for a member to seek informed consent before receiving a commission, fee or other benefit will introduce the necessary flexibility to ensure a client's preference for remunerating the member can also be accommodated where appropriate. For example, one member stated they have implemented a fee for service remuneration model for investment advice but after 12 months their client requested they go back to remunerating the member via asset based fees. Requiring informed consent, combined with the new legislative requirements, provides a flexible professional standards framework that allows the member to consider and where appropriate accommodate such requests while ensuring compliance with the fundamental principles.

Importantly, informed consent coupled with the other legislative provisions provide a consistent and robust framework that address or have the potential to address the different conflicts of interest that may arise as a result of adopting different remuneration models be they asset based fees or commissions.

CPA Australia and the Institute recommend that the APESB introduce the informed consent obligation when a commission, fee or other benefit may be received by a member.

Recommendation:

6. APES 230 introduce the additional obligation to obtain a client's informed consent (which is at a higher level than disclosure), before a commission, fee or other benefit can be received.

6. The Code and proposed standard APES 230

For professional accountants in Australia the fundamental ethical principles that must be adhered to are enunciated in the Code. The Code requires members to comply with the fundamental ethical principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

All professional standards issued by the APESB are based on the Code and its conceptual framework relating to the conduct and performance of professional services across various types of professional engagements.

Financial planning is a highly regulated industry and is undergoing further regulatory change. It is also recovering from the impact of the global financial crisis. These factors and the potential impact of the standard

as drafted have resulted in the proposed standard receiving a high level of engagement from both members of the accounting profession and other industry participants.

It is important that there is clear understanding and consistency in the development of APES 230 to ensure the proposed standard reflects the fundamental principles of the Code.

Commissions and the Code

Paragraph 240.5 of the Code states that accepting commissions creates a self-interest threat to objectivity and professional competence and due care.

To address this, Paragraph 240.7 of the Code requires members to evaluate the significance of the threat and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level. In addition to this, the Australian paragraph AUST240.7.1 requires members in public practice who are undertaking an engagement in Australia and receive a commission to inform the client in writing of:

- the existence of such arrangement
- the identity of the other party or parties; and
- the method of calculation of the referral fee, commission or other benefit accruing directly or indirectly to the member.

Paragraph 9.1 of APES 230 states that there are no safeguards that can reduce threats created by third party payments or soft dollar benefits to an acceptable level. It is unclear from the draft standard and the EM how that conclusion has been reached and why safeguards are unavailable, given that the Code proposes potential safeguards to eliminate or reduce to an acceptable level threats created by commissions.

7. Scope of the APES 230

Taxation Services

The EM states that it is not the intention of the draft standard to apply to Taxation Services, but only to the tax considerations that arise from the provision of financial planning advice. However, the specific inclusion in the definition of financial planning advice of 'taxation advice which is related to advice provided under (a) or (b)' will we believe capture a broader range of taxation advice than what the EM states is intended.

This will potentially require registered tax agents to comply with both the obligations of APES 220 *Taxation Service*s and the APES 230 *Financial Planning Services* when providing this advice. Notably, the requirements of the proposed APES 230 in terms of the basis for providing and documenting the advice appear more onerous and are not consistent with the way in which this type of advice would currently be provided.

A transitional framework will also commence in July 2013 which will require financial planners to register with the Tax Practitioners Board in order to continue providing tax advice in the context of financial planning advice. From the end of this transition period only financial planners who have registered with the TPB to provide tax advice in the context of financial planning advice and Registered Tax Agents will be able to provide taxation advice in the context of advising and dealing in financial planning products.

Given this and the fact that the intention of the ED is not to capture Taxation Services we recommend (c) is removed from the current definition of Financial Planning Advice. This will provide clarity as to the intended scope of the standard.

Recommendation:

7. Section (c) is removed from the current definition of *Financial Planning Advice* to ensure Taxation Services are not unintentionally captured by APES 230.

Mortgage Broking Services

It is stated in the EM that the provision of Financial Planning Services is considered an integrated discipline comprising advice on all personal wealth management matters. Therefore the ED addresses all financial planning advice provided by a member to clients on wealth management, retirement and estate planning, as well as insurance, risk and mortgage broking services.

However, advice on wealth management, retirement planning, insurance and risk products are all regulated by the *Corporations Act 2001* which enforces a range of compulsory requirements including licensing under the Australian Financial Services Licensing regime. Mortgage broking, and related consumer credit advice, is regulated under the *National Consumer Credit Protection Act 2009* which requires licensing under the Australian Credit Licensing regime.

We understand that the APESB has concluded that they consider personal wealth management matters to include consumer credit advice. However, the result of this decision is that the standard will apply to a broad range of services. This in turn imposes a number of additional obligations on members providing mortgage broking services which may add unnecessary complexity.

For example, paragraph 3.6 of the proposed standard requires members providing financial planning services to act in the best interests of their client which means the obligations defined in Division 2 of Part 7.7A of the *Corporations Act 2001*. These obligations will apply to all licensed financial planners providing retail financial services. However, members providing mortgage broking are not subject to these obligations and rather must comply with the general conduct obligations as defined in Division 5 or Part 2.2 of the *National Consumer Credit Protection Act 2009.*

To address this potential confusion and complexity, CPA Australia and the Institute recommend that the APESB remove mortgage broking, including other advice and services related to the procurement of loans and other borrowing arrangements, from the scope of APES 230. This will ensure the requirements and obligations of the standard as currently drafted will appropriately apply to the correct provision of advice and services. It will also avoid confusion and uncertainty about a Members obligations under law and APES 230 with regard to these types of services.

Should the APESB determine that consumer credit services should continue to be captured by APES 230, the draft standard should be amended to accurately reflect the applicable obligations and requirements under both the *Corporations Act 2001* and the *National Consumer Credit Protection Act 2009* for each area of discipline. The title should also then be amended to ‘Financial Advisory Services’ or ‘Financial planning and credit services’ in order to also accurately reflect the scope of the proposed standard and reflect industry terminology.

Recommendation:

8. Section (d) advice and services related to the procurement of loans and other borrowing arrangements, including credit activities provided pursuant to an Australian Credit Licence be removed from the definition of *Financial Planning Advice*.

OR

APES 230 be redrafted to accurately reflect the scope of the advice covered by the standard and references applicable requirements under both the Corporations Act 2001 and the National Consumer Credit Protection Act 2009. In this instance, the title of the standard is amended to ‘Financial planning and credit services’ to also accurately reflect the scope of the standard and reflect industry terminology.

Strategic and structural advice

The APES 230 ED defines *Client* to mean a natural person, whether the person operates as a sole trader or through a partnership, corporation or trust which the person controls. The definition of *Financial Planning Advice* entails advice in respect of a Client’s financial affairs specifically related to wealth management, retirement planning, estate planning, risk management and related advice.

While the intention may be to capture advice in respect of a Client's personal affairs, as drafted the standard will in fact capture a much broader range of advice including advice provided to small business entities. Further, the broad definition of *Client* and the inclusion of strategic and structural advice that does not require an Australian Financial Services Licence in the definition of *Financial Planning Advice* has the potential to capture all advice provided by a Member in public practice.

As advised in our earlier submission, Members in public practice regularly provide advice on business matters including appropriate business structures e.g. establishing, running, winding up companies, trusts, partnerships, buying and selling businesses, legal advice and underwriting in share floats.

The inclusion of 'advice that does not require an Australian Financial Services Licence, such as real estate and on-product related advice on financial strategies and structures' has the potential to capture a broad range of traditional accounting advice provided by Members in public practice. This creates we believe unnecessary uncertainty over the intended scope of the standard.

For example, Members in public practice regularly provide what they would consider wealth accumulation advice to clients which would include:

- appropriate business structures, including establishing a business
- advice on running and winding up a company; and
- buying and selling businesses.

There are also further regulatory reforms such as the future removal of the accountants' licensing exemption under FoFA which are expected to either clarify or define the terms 'class of product' advice and 'non-product' advice.

CPA Australia and the Institute therefore recommend that clarity of the scope of the standard is refined to provide further clarity.

Recommendation:

9. To provide clarity over the intended scope of the standard, section (e) of *Financial Planning Advice* is removed until current regulatory reforms are progressed. This decision can then be reviewed post implementation.

8. Proposed timeline for implementation

Proposed commencement date if recommendations one to five are adopted

CPA Australia and the Institute strongly believe the proposed commencement date of 1 July 2013 must be revised to ensure an effective and smooth transition.

Should the APESB adopt recommendations 1 to 5, CPA Australia and the Institute recommend the standard be amended to commence 1 July 2014. This commencement date will ensure an appropriate amount of time to both develop and implement the additional safeguards that we have recommended, such as informed consent.

A key component to the successful implementation of a standard is having a robust monitoring, supervision and enforcement framework. CPA Australia and the Institute of Charted Accountants will also be required to review and update their respective Quality Review programs to monitor compliance with the standard. To develop and implement a successful Quality Review monitoring framework without imposing unnecessary compliance, duplication and burden will take a minimum of eighteen months.

It is clear that significant resources, including both time and funding, will be required to:

- review and develop new processes
- pilot new programs to assess effectiveness
- training of staff; and

- training of Quality Assurance assessors.

Until the standard is ultimately finalised, we cannot appropriately scope and determine the resources that will be required.

We request the APESB take into account the obligations and potential requirements of the professional accounting bodies, who are responsible for assisting members transition to the new requirements and monitoring adherence, when finalising its decision on the commencement date of the proposed standard.

Recommendation:

10. Should recommendations one to five be adopted, we recommend the commencement date of the standard is amended to 1 July 2014.

Proposed commencement date if recommendations one to five are not adopted

Due to the wide range of significant complexities and implications of the proposed standard we have been required to consider various alternative implications and outcomes.

The Explanatory Memorandum states that the FoFA reforms have a mandatory commencement date of 1 July 2013 and therefore the Board determined to align the commencement date of the proposed standard with the FoFA reforms.

It should be noted the scope of the FoFA reforms do not go as far as those proposed within APES 230. For example, FoFA will not ban commissions from being received on most insurance products. This is a significant difference between the proposed standard and FoFA, as FoFA will not require Life Insurance companies to change the structure of the vast majority of their current insurance products, including changes to the payment of commissions.

Discussions with a number of life insurance companies have revealed that they are looking at ceasing commission payments to financial planners and instead replacing these payments with a fixed flat fee. Scoping alternative payment models to commissions, which would still be tied to the placement of product, demonstrates their desire to retain the current model of paying financial planners to distribute their product. Retaining payments tied to the placement of product will continue to act as a barrier for the industry to implement and provide risk advice on a fee for service basis.

Also, all life insurance companies have recently agreed to a new self-regulatory model developed by the Financial Services Council (FSC) effective from 1 January 2013. The policy was developed to address concerns of ‘churning’ of insurance products by some financial planners. To address this concern the new model will require financial planners to repay 100% of the commission if the policy lapses in the first year, 75% in the second year and 50% in the third year. The policy demonstrates a further reluctance to move away from this remuneration model and to instead implement new safeguards to address potential conflicts. The effect of this is that institutions and their associated licensees will in turn not change their current remuneration practices or amend current reporting systems.

Indications are that the majority of our members in public practice licensed under another entity’s AFS licence, will not be supported by either the product providers or their licensees to provide insurance advice on a fee for service basis in the medium term and certainly not by 1 July 2013.

While the FoFA reforms will also ban asset based fees on geared amounts, gearing is not a common strategy that is this is not a strategy that is widely recommended. Further, in 2009 the industry began to shift away from remuneration models based on commissions from investments and superannuation products. The announcement of the FoFA reforms further encouraged this and resulted in increased access to training and resources to assist financial planners review their value proposition and business models. The reality is many financial planners and businesses who have undertaken this change have moved from a commission based model to a percentage of assets based model.

Also the changes to remuneration which will be implemented by the FoFA reforms will not apply to existing arrangements. The significance of this is that members currently receiving commissions will not be required to

cease receiving these payments or develop processes, at their cost, to rebate the commission back to the client. The FoFA reforms will also prohibit a product issuer or seller from giving a AFS licensee, or a representative of a licensee, conflicted remuneration as defined in the *Corporations Act 2001* from 1 July 2013. This removes the burden from licensees of having to otherwise amend systems to account for these types of payments.

The key aspect of APES 230 is the proposed changes to current remuneration practices. The vast majority of our members in public practice operate under another entity's AFSL. As a consequence, the ability of members and their practices to comply with APES 230 will be dependent on the acceptance of the standard by the licensee and the allocation of resources to assist the member to implement the necessary changes to comply with the proposed standard.

Also of importance the FoFA reforms will not apply to the lending and mortgage broking industry. While this industry has undergone significant legislative reform in recent years, the reforms introduced by the Government has not introduced any changes to existing remuneration models. The lending and mortgage broking industry is and continues to be based on commission based remuneration.

Should the recommendations in this submission not be adopted, CPA Australia and the Institute believe further assessment must be undertaken with the industry to assess the capacity and how long it may take to implement a fee for service remuneration model. It should explore the impact on the provision of advice, specifically insurance and mortgage broking, and other transitional issues such as the rebating of existing commissions. We would envisage a need for a substantial transition time to be put in place to work through these matters.

9. Definitions

Following our recommendations and a review of the current definitions in the ED, we recommend the following amendments.

Commission means all monetary amounts received by a Member or Firm from a product provider, licensee or related party, other than the client, which is calculated as a percentage value of product investment, insurance premium payable or credit secured.

Financial Planning Advice means:
a) advice relating to financial products as defined in section 766B of the *Corporations Act 2001 ; and*
b) advice and dealing in financial products as defined in section 766C of the *Corporations Act 2001.*

Financial Planning Service means a service where a Member provides personal Financial Planning Advice to a Client.

Third Party Payments means all amounts received by a Member based on volume, production bonuses or other remuneration benefits based on the sale of in-house products. Third party payments excludes commissions, non-recurring fixed referral fees received by a Member as a result of referring a Client to another service/product provider and are disclosed to the Client by the Member.

Wholesale client has the same meaning given by section 761G.

10. Drafting

Best Interests of the Client

As drafted, 3.6 requires members to act in the Best Interests of the Client when providing a financial planning service. However, when it comes into effect on 1 July 2013 the best interests obligations will apply to retail clients not wholesale clients.

While we believe that members should act in the best interests of all Clients regardless of whether they are retail or wholesale clients, the requirements of s961B(2) potentially imposes a number of obligations on members providing advice to a wholesale client that are not required by law.

In acknowledgement of this we recommend the following paragraph is added following the current 3.6:

A Member providing a Financial Planning Service to a wholesale client should act in the Best Interests of the Client to the extent practicable.

This amendment would confirm the general obligation remains to ensure advice is in the best interests of the client, without unnecessarily imposing new requirements when providing financial planning advice to wholesale clients.

Basis for the Financial Planning Advice

As previously noted, there are a number of obligations that apply to the provision of advice to retail clients that are not required by law when providing advice to wholesale clients. In acknowledgement of this we recommend the following paragraph is added following the current 6.7:

A Member who provides Financial Planning Advice to a wholesale client should follow the reporting requirements in paragraphs 6.1 to 6.6 to the extent practicable.

Reporting the Financial Planning Advice

As previously noted, there are a number of obligations that apply to the provision of advice to retail clients that are not required by law when providing advice to wholesale clients. In acknowledgement of this we recommend the following paragraph is added following the current 6.8:

A Member who provides Financial Planning Advice to a wholesale client should follow the reporting requirements in paragraph 6.8 to the extent practicable.

Professional fees

Following our earlier comments, we recommend that paragraph 8.1 to 8.4 be amended as follows.

8.1 A Member in Public Practice shall determine and charge a professional fee for providing a Financial Planning Service to a Client that takes into account a range of factors. This may then be expressed or collected as a percentage of the value of the Client's assets or funds under management (or any component of, or changes in such values).

8.2 Factors that a Member in Public Practice shall consider in determining the professional fee for a Financial Planning Service include the nature and complexity of the Financial Planning Service, the scope and scale of the service provided, the level of experience and expertise of the Member and the Member's staff, the degree of responsibility applicable to the work, inherent risks associated with the service, the time spent on the Financial Planning Service and the value of the Client's assets or funds under management.

8.3 If a Member in Public Practice proposes to make a material chance to the basis upon which the Member charges professional fees, the Member shall notify the Client and obtain the Client's written consent to the amended terms in accordance with APES 305 Terms of Engagement.

8.4 A Member in Business who undertakes a Financial Planning Service should follow the requirements and guidance of Section 8 of this Standard to the extent practicable.

Third Party Payments

Consistent with our earlier recommendations and drafting amendments, we recommend section 9 be reworded as follows:

9.1 A Member in Public Practice shall not accept Third Party Payments or Soft Dollar Benefits in relation to a Financial Planning Services provided by the Member, except as provided for in paragraphs 9.2 to 9.4.

9.2 With the Client's knowledge and agreement, a Member in Public Practice may accept a payment of all or part of the professional fee in respect of a Financial Planning Service provided to the Client from a party associated with the Client. Such parties may include family members and associated entities.

9.3 A Member in Public Practice may accept a Soft Dollar Benefit which is trivial and insignificant, provided the Member:

- *records it in a register within 10 business days of receipt;*
- *maintains the records of the Soft Dollar Benefit for 5 years after receipt;*
- *makes the register available for inspection by the Member's Financial Planning Service clients and the Member's Professional Body within 2 business days or request or as required by regulatory authorities; and*
- *includes a specific reference to the availability of these records in the Member's Financial Services Guide and Statement of Advice.*

9.4 A Soft Dollar Benefit is trivial and insignificant if it is for gifts or other incentives as defined in Division 2 of Part 7.7A of the Corporations Act 2001 to a value of not more than $300.

Under FoFA an individual will be able to receive a non-monetary benefits where at least 75 per cent of the time spent on a course must be spent on education or training activities for professional development. The participant or their employer must pay for the costs of travel and accommodation relating to the course and events and functions held in conjunction with the course. CPA Australia and the Institute recommend the APESB consider expanding the soft dollar benefits that can be received to also permit the receipt of PD that meets these requirements.

Further, the obligations as drafted in section 9 currently center on the legislative requirements for the provision of licensed financial planning advice under an AFSL. Should the APESB determine that APES 230 should also include advice and services provided under an ACL, this section must be redrafted to provide a more flexible framework applicable to all advice captured by the standard.

Transitional provisions

Should the recommendations in our submission be adopted by the APESB, we recommend the transitional provisions in section 11 are removed from the standard.

APPENDIX – Industry and practice matters

Provision of insurance advice

CPA Australia and the Institute acknowledge that commissions are a form of conflicted remuneration. Despite the government also acknowledging this, the ban on commissions under FoFA will exclude commissions on life insurance products outside of superannuation, life policies within a default superannuation fund and group schemes within superannuation.

The Financial Planning Association and the Financial Services Council also permit the receipt of commissions, provided they are fully disclosed to the client.

The specific exclusion of these types of payments by the government and industry bodies offers no incentive for Life Insurance Companies or the industry to move away from this form or remuneration model. In fact, financial planners are currently seen as an effective and efficient distribution model for insurance product providers and given this have little appetite to change.

In 2010 Rice Warner Actuaries calculated the fact that over 95 per cent of families do not have adequate insurance and in fact Australia is underinsured by $1.37 trillion. While we do not support the argument that commissions must solely be retained to address the underinsurance problem that currently exists, this statistic supports the fact that there does not appear to be a systemic issue that must be addressed through banning this form of remuneration.

Consideration must also be given to how a member of the professional accounting bodies could successfully provide risk advice to a client on a fee for service basis in an environment where remuneration models, systems and valuations of practices continue to be built on commissions.

Feedback from our members clearly demonstrates they strongly believe they will be unable to compete in the risk advice market if they are required to operate purely on a fee for service basis. They believe that their clients will not pay for the true cost of providing risk advice and would prefer the member is remunerated via commissions.

There is also concern that operating on a fee for service basis may in fact pose a potential conflict with complying with the future obligations under the best interests duty obligation. For example, consider the following table for two different types of insurance cover.

	Amount of Cover	Cost of premium to client	Commission (level)	Cost of premium where commission reduced to $0	Saving to client	Difference between saving to client and commission
Life Insurance	$500,000	$266,.28	$80.55	$212.04	$54.24	$26.76
Income protection	$5,000 per month	$1,243.92	$361.15	$963.96	$279.96	$81.19

In order to comply with APES 230, a Member may choose to reduce their commission to zero and so eliminate the need and associated cost of rebating the commission to the Client. In this instance the Client will not receive an equal reduction in the cost of their premium. It would therefore appear to be in the best interests of the Client to receive and rebate the Commission, which would then result in the financial planner incurring additional ongoing costs.

While commissions will be banned on group life policies within superannuation, these types of policies tend to have a short underwriting process up to a relatively high automatic acceptance level (AAL), with little chance of the cover being rejected. As the underwriting is done a bulk group basis within a pool there is considerably less work required to secure cover for the Client. The associated fee to provide this advice and secure the cover will also be considerably less compared to securing appropriate cover for the client directly with a insurance product provider.

As the AAL also provide high levels of cover, it is common that individuals seeking insurance through a group policy go direct to the superannuation provider rather than seek the advice of a financial planner. It is therefore not unreasonable to ban commissions on these products, as individuals within the cover are normally non-advised clients.

MySuper will provide a default superannuation arrangement, which will be new product to the market. This makes it easier to develop and offer a product where no commissions will be paid, removing complexity and the need for grandfathering provisions.

Impact on valuations of practices

Requiring members to implement a pure fee for service remuneration model for all clients will have an immediate and adverse impact on the value of the members financial planning practice.

Currently the market places a much higher resell value on a financial planning practice than an accounting practice because of the recurring income stream nature of a financial planning business.

Where the financial planning business has recurring income of less then $1.5 million, over 90% of valuations use a recurring income valuation method where the valuation multiple is a multiple times the income generated by the product. Currently the following multiples commonly apply to different products:

- Risk income 3.0 - 3.5
- Superannuation and investment 2.7 – 2.9
- Income stream 2.5 – 2.6
- Corporate superannuation 1.50 – 1.75
- Mortgage book 1.25 -1.50

These multiples clearly demonstrate that the market is placing a higher value on commission based products.

While some institutions are advocating publicly for a move to fee for service remuneration, excluding insurance, these same groups are commonly buying advice fee practices at only one multiple.

Many of our Members in Public Practice will be small business owners who have set up their practice with the view that it would also fund their retirement. Mandating these practices to move to a pure fee for service model will not only impact their revenue streams in the short term but also the value of their practice when they retire. These members have established and built their business in good faith based on both the legislation and the requirements of their professional accounting body.

Provision of credit advice

As with the insurance industry, the credit and mortgage broking industry's remuneration models, systems and valuations of practices continue to be built on commissions.

Requiring members of the accounting profession to provide such advice on a pure fee for service basis will create significant administrative burden and complexity on members who have little influence to change supplier systems and processes.

As well as the potential administrative and cost burden to rebate commissions received, it is not uncommon for lenders to have clawback provisions which can be enforced for up to two years after the loan has been drawn. In the instance where these commissions were rebated, the Member would be forced to bear the cost.

Feedback again demonstrates our members strongly believe they will be unable to compete in the credit market if they are required to operate purely on a fee for service basis. Rather, they believe their clients will instead seek the same advice from participants outside of the accounting profession.