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10 March 2020

Chief Executive Officer
Accounting Professional and Ethical Standards Board Limited
Level 11
99 William Street
Melbourne VIC 3000

By email: sub@apesb.org.au

Dear Mr Wijesinghe,

AFA Submission: Review of APES 230 Financial Planning Services

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for over 70 years. Our objective is to achieve *Great Advice for More Australians* and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

The Board of the AFA is elected by the Membership and all Directors are currently practicing financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting wealth.

Introduction

The AFA appreciates the opportunity to make a submission as part of this consultation by the APES Board with respect to APES 230 Standard on financial Planning Services.

It is important to note that since the release of this consultation paper on 17 December 2019, there have been two key developments relevant to this standard:

- On 20 December 2019, FASEA released a document titled "Preliminary Response to Submissions – FG002 Financial Planners and Advisers Code of Ethics 2019 Guidance". This document answered some of the questions that have emerged since the release of FG002 Financial Planners and Advisers Code of Ethics 2019 Guidance on 18 October 2019. It also highlighted FASEA's commitment to further consultation, as part of a process to provide greater certainty for the financial advice sector.

- On 31 January 2020, the Australian Treasury released a large batch of exposure draft legislation, including a response to Recommendation 2.1 from the Royal Commission on Annual Renewal and Payment and Recommendation 3.3 on the payment of advice fees from superannuation accounts.

It is our view that both of these releases are an important element in the broader regime for financial advice fees and remuneration and are relevant to the review of APES 230. They are however, clearly both just steps in the journey towards providing clarity and certainty with respect to the ultimate requirements. The final outcome with respect to the FASEA Code of Ethics and the changes to the Corporations Act to implement Annual Renewal may still take some months to emerge. The APES Board will need to be conscious that this consultation on APES 230, is being undertaken in the absence of broader regulatory certainty.

Many of the key stakeholders in the financial advice sector have made submissions to both FASEA on the Code of Ethics and Treasury on Recommendations 2.1 and 3.3. FASEA have not made a habit of releasing the submissions that they receive from industry stakeholders, however Treasury normally do, although it may take some time. It would be sensible for the APES Board to seek input on the consultation undertaken by both FASEA and the Treasury.

Response to Questions raised in the Consultation Paper

1. **In view of substantial changes in the financial services industry since APES 230 became effective in July 2014:**
   a) Do you consider that APES 230 remains fit for purpose?
   b) What amendments or enhancements, if any, should be made to APES 230?
   c) Are there any tools or templates that could be included in APES 230 to assist with complying with the standard?

APES 230 goes further than the current law in a number of areas, however with the implementation of the current regulatory reforms related to the FASEA Code of Ethics and the Royal Commission recommendations, it seems likely that this gap will close markedly. It should also be noted that APES 230 only applies to a sub-section of the financial adviser market, being accountants.

It is the AFA's view that in the context of the current regulatory reform agenda, the current APES 230 standard provides a sensible balance between the competing pressures of the demands of a profession and the practical realities of the financial services industry and the financial advice sector.

We do not propose the need for any amendments or enhancements to APES 230.

There is an opportunity to provide more tools and templates to assist with complying with the standard, however it may be necessary to wait for the finalisation of other matters such as the proposal that ASIC will determine a client consent form template (as per the proposed Section 962T of the Corporations Act) and other things that may emerge from the finalisation of the guidance on the FASEA Code of Ethics.

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

The definition is singularly focussed upon advice to people in their personal capacity and may therefore not incorporate advice to companies, trusts and small businesses.

It is noted that it does not exclude advice provided to wholesale clients, which is, in our view, an appropriate approach, particularly given that the FASEA Code of Ethics does not apply to advisers who only provide advice to wholesale clients and the fact that the Fee Disclosure Statement and Opt-in obligations do not apply to wholesale clients.

We have no objection to the fact that the APES 230 obligation applies to mortgage broking services and that it should also apply to strategic advice and real estate advice. It is important to note that most financial advisers will not be permitted by their licensee to provide advice on a specific property, however, will instead provide advice with respect to the level of exposure to the property sector as a whole. It is also important to note that a lot of property is owned within the SMSF sector and it is therefore appropriate that obligations apply in this context.

3. **APES 230 requires Members to act in the 'Best Interests of the Client' (as per the Corporations Act 2001):**
   a) Have there been any implementation issues in respect of this requirement?
   b) Do you consider the 'safe harbour' provisions in the Corporations Act 2001 ensure clients' best interests are met?

We are not aware of any issues with respect to the implementation of the best interests of the client requirement under APES 230.

More broadly there have been significant issues with the implementation of the Best Interests Duty in the financial advice sector. Over a number of years, ASIC has released a number of reports highlighting poor outcomes with their assessment of the level of compliance with the Best Interests Duty. This has included Report 413 on life insurance advice, Report 562 on superannuation switching advice within vertically integrated groups, Report 575 on SMSF advice and more recently Report 639 on superannuation fund advice.

We are conscious that the safe harbour steps in Section 961B(2) were subject to some questioning in the final report of the Banking Royal Commission, and there are arguments both in favour of it and opposing it. We do not believe that the Royal Commission adequately set out a case for why it might not be appropriate, and we favour the continuation of the safe harbour steps. This is an issue for consideration as part of a proposed review of financial advice in 2022. In the absence of evidence to suggest that the safe harbour is contributing to poor outcomes for consumers, we would recommend that it be retained.

There has been one other major influence on the financial advice sector with respect to the application of the Best Interests Duty, which is ASIC Report 515 Financial Advice: Review of how large institutions oversee their advisers. ASIC Report 515 was released in March 2017, however has had an ongoing impact, as ASIC has ramped up their response, with the large institutional groups. This has resulted in some fundamental changes to the way these businesses operate, including the addition of lengthy checklists and enhanced record keeping obligations.

4. **APES 230 currently allows remuneration as fee for service, asset based fees and third party payments (subject to laws and regulations). If APES 230 is limited to only allow fee for service:**
   a) What are the challenges, if any, that Members consider would result from implementing these changes?
   b) Are there any transitional arrangements required?

The impact of these changes would be substantial. Both asset-based fees and life insurance commissions are very major elements in the current business income models. Our first point is that we do not see any need for the removal of either asset-based fees or life insurance commissions.

In Regulatory Guide 175, ASIC have stated a very clear view that the receipt of asset-based fees does not prevent an adviser from describing themselves as independent. It is also a fact that some clients prefer to have their adviser paid on the basis of an asset-based fee arrangement. They like to see that their adviser has some "skin in the game". And this is exactly the case at present, as we observe the material declines in the value of the Australian and international share markets as a result of the Coronavirus. As the client's assets go down, so does the income of the adviser. We also struggle with the assumption that hourly fee arrangements or fixed fees are completely free of conflict, yet there is something inherently wrong with asset-based fees. There are risks with each of the models. In terms of an hour fee arrangement, this provides an incentive to take longer to complete the work, or to provide services that are not important to the client. Ultimately, we believe that clients should have the ability to choose how they pay for their financial advice, and asset-based fee arrangements are an option that many may choose.

In terms of asset-based fees, this still represents a significant amount of the financial advice sector income. Investment Trends research in 2019, indicated that asset-based fees represent 28% of practice income, which is somewhat less than the 37% for flat fees, but still a very material amount.

Since the introduction of the Life Insurance Framework (LIF), upfront commissions for life insurance advice have been subject to a cap. In 2020, the cap is 60% of the first year's premium. The amount that the adviser is paid is largely independent of which life insurer that they recommend. Commission rates can no longer inappropriately influence the selection of the insurer. Life insurance commissions have been the focus of some major reviews and the Parliament has decided to permit their continuation under the LIF. Subject to the agreed ASIC review in 2021, we can see no need for any consideration of further change at this stage.

According to research by Investment Trends in 2019, upfront and servicing commissions on life insurance business make up a total of 23% of practice income. Fees for life insurance advice is a very small percentage of total income, and it does not even rate a mention in the Investment Trends research. Research undertaken by Zurich in 2019 (The Risk Advice Disconnect), demonstrated that only 8% of life insurance advice clients are prepared to pay more than $1,000 in fees for life insurance advice. Given that it costs more like $2,500 to provide life insurance advice, this paints the picture of a model that would be substantially unsustainable if commissions were banned.

If forced to change, the transition impact would be substantial. If advisers were forced to move their clients from an asset-based fee arrangement to a fixed fee arrangement, then they would need to sit down with each client and negotiate a new arrangement. For some clients, this may be a difficult and drawn out process. This transition would involve a significant cost, which could not be recovered from clients.

In the case of life insurance advice, the reality is that most advisers would simply walk away from providing life insurance advice or otherwise only focus upon the high income earners. The 2019 research by Zurich indicated that in the context of a commission ban, 50% of advisers would cease providing financial advice, whilst 12% would entirely cease providing life insurance advice and 22% would reduce their life insurance advice and focus upon other forms of advice. A ban on life insurance commissions would lead to a significant reduction in the amount of financial advice provided on life insurance. This would be a bad outcome for consumers and the country in general.

5. **APES 230 requires Members to obtain their clients' 'Informed Consent' in respect of asset-based fees and third party payments, but not for fee for service. If Informed Consent is required for fee for service arrangements in APES 230:**
   a) Are there any new systems, processes and/or policies that Members would need to implement?
   b) What are the challenges, if any, that Members consider would result from implementing these changes?
   c) Would the inclusion of a template in APES 230 which includes matters to be disclosed to clients to obtain Informed Consent for remuneration be useful for Members?

The requirement for informed consent is part of the FASEA Code of Ethics and relevant to the Royal Commission recommendation on Annual Renewal. Currently all post 1 July 2013 (FoFA) clients are required to Opt-in to continue an ongoing adviser service fee arrangement every second year. What is proposed is that this would be extended to all ongoing fee arrangement clients and with the frequency reduced to an annual obligation. The proposed law, in its current form, is a requirement for three separate documents, being a client agreement, an Opt-in notice and a client consent form(s) which would need to be provided to the product provider(s). Implementation of client consent for all ongoing fee for service clients can be achieved with the current systems, however processes and policies would need to be updated to incorporate these major changes. It is noted that informed consent is going further than the law, however this is the expectation of the FASEA Code.

The challenges to implement these changes are the significant workload involved in this exercise and the fact that it would need to be done at the same time as the financial advice sector confronts a whole bunch of other changes (FASEA Exam, education requirement, banning of grandfathered commissions and the FASEA Code of Ethics). Further training would be required to assist advisers who were expected to undertake this obligation.

Section 962T of the exposure draft legislation for Annual Renewal includes provision for ASIC to establish the requirements for the product provider client consent forms. It would seem that having APES also define another template may be duplication. However, should the APES Board proceed with this step, then the production of a template, as a voluntary guide only, would be beneficial.

6. **The Financial Services Royal Commission recommended that 'hawking' (unsolicited offer or sale) of superannuation and insurance products should be banned (recommendations 3.4 and 4.1):**
   a) Does the requirement that Members' marketing or promotional activities must not bring the profession into disrepute adequately prevent unsolicited offers or sales in practice?
   b) If not, are there other mechanisms that could be put in place to prevent the unsolicited offer or sale of financial products?

The Government has committed to introduce a ban on unsolicited telephone based sales (hawking) as law and it seems somewhat pointless to also build this into the APES 230 obligations. The AFA is supportive of a ban on unsolicited telephone sales, and believes that the best approach to achieve this is through legislative change. This ban will not be extended to email or mail based campaigns, which we would consider to be appropriate.

We support an obligation that marketing and promotional activity should be appropriate and ethical and accept that this may also be covered through professional conduct provisions in a Standard.

There is one key element of this that needs to be carefully considered, which is the implications for a financial adviser proactively contacting their existing clients about the suitability of their current

insurance arrangements. It is important to ensure that this does not serve to prevent an adviser proactively working with their existing clients.

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

It is our view that a Terms of Engagement document is one way to document the achievement of informed consent, and this may become an integral part of the process for financial advice arrangements to be established and renewed.

More broadly, the provision of financial advice, through a Statement of Advice or a Record of Advice, should already include an expectation that the financial adviser has obtained informed consent. Informed consent has been a key element of the Association of Financial Advisers Code of Conduct for a number of years.

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

We can see no reason for the removal of the non-monetary benefit exemptions and the $300 cap. The cap, along with the training and education exemption ensures that the amount of the benefit and the nature of the benefit is highly unlikely to influence future financial advice. Having access to these exemptions ensures that financial advisers can attend training and related events that are run by product providers. This is a useful source of continuing professional development activity, that only serves to ensure that the adviser is well educated and that their knowledge is kept up to date. It makes no sense to make changes that could effectively ban attendance at these events.

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

The definition of conflicted remuneration as set out in Section 963A only applies in the context of the provision of financial product advice to persons as retail clients. This effectively excludes wholesale clients. The ban on asset-based fees on borrowed funds in Section 964D is restricted to retail clients as set out in Section 964B. This effectively means that a financial adviser can charge asset-based fees on borrowed funds to a wholesale client. The AFA does not consider this to be appropriate.

It is not evident to us that Paragraph 8.2 of APES 230 would prevent the charging of an asset-based fee on a borrowed amount. Therefore, we would support the APES Board taking action on this.

10. Are there any further reforms, issues or ideas that you believe the APESB should consider in APES 230 in order to protect consumers who receive financial advice from a Member?

The financial advice profession is subject to significant reform across a number of initiatives at the same time. These changes include the FASEA exam requirement, the education requirement, a ban on grandfathered commissions, fundamental changes to income protection insurance, Annual Renewal and disclosure of lack of independence amongst many others. This is on the back of other recent reforms, such as FoFA, MySuper and the Life Insurance Framework. All of these changes are in different stages of implementation and the full impact has not been assessed. Many in financial advice are particularly concerned that the cumulative impact of these changes is significantly impacting the cost of providing financial advice, and as a result placing a genuine threat on the accessibility and affordability of financial advice for everyday Australians.

Concluding Remarks

The AFA recognises the lead taken by the APES Board in the original introduction of APES 230 and that this standard is now the subject of review. We trust that our input on these issues will be beneficial in the understanding of the current environment for financial advice and the existing substantial agenda for reform.

The AFA welcomes further consultation with the Accounting Professional and Ethical Standards Board should it require clarification of any points raised in this submission. If required, please contact us on (02) 9267 4003.

Yours faithfully,

Phil Anderson
General Manager Policy and Professionalism
Association of Financial Advisers Ltd