

SUBMISSION

ACCOUNTANTS
FACE A FORK IN
THE ROAD ON
FINANCIAL ADVICE:
PROFESSIONALISM
OR SALES

EXPOSURE DRAFT
APES 230 –
FINANCIAL ADVISORY
SERVICES

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Industry
Super
Network

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About Industry Super Network

Industry Super Network (ISN) is an umbrella organisation for the industry super movement. ISN manages collective projects on behalf of a number of industry super funds with the objective of maximising the retirement savings of five million industry super members. Please direct questions and comments to: Robbie Campo, ISN Manager – Strategy, rcampo@industrysuper.com

| INTRODUCTION

ISN strongly supports the direction of regulatory change proposed in *Exposure Draft APES 230 - Financial Advisory Services*. In particular, we support the imposition of a fiduciary relationship on accountants who provide financial advisory services to clients and the requirement to remove conflicts of interest especially those created by certain types of fees and remuneration.

By way of context, the Federal Government is currently undertaking a comprehensive reform process to address the serious structural conflicts of interest within the financial planning and wealth management industry (called the Future of Financial Advice or 'FOFA' reforms). This includes the imposition of a requirement in the Corporations Act to act in a client's best interests when providing personal financial advice. The reforms being undertaken by the Federal Government follow the recommendations made by the Parliamentary Joint Committee on Corporations and Financial Services which examined a number of high profile collapses of financial advice businesses including Storm, Opes Prime and Westpoint. It should be noted that there were accountants providing financial advisory services involved in some of these collapses.

The draft Standard appropriately goes beyond what is intended in the proposed reforms of the Corporations Act and will ensure that all accountants providing financial advisory services are providing high quality, unbiased, strategic advice. The imposition of a fiduciary standard and comprehensive regulation of remuneration which is consistent with the fiduciary standard will ensure that the process of providing financial advice by accountants is entirely disaggregated from the sale and distribution of financial product or accumulation of funds under management.

If the Standard were to be implemented, the accounting profession would certainly be subject to higher professional and ethical standards than those required by the Corporations Act (even after the proposed reforms are implemented) and by the professional standards imposed by the Financial Planning Association or the Association of Financial Advisers. Notwithstanding some commonality between measures in the FOFA package and APES 230, the accounting profession will be unparalleled in setting rigorous ethical and professional standards to ensure that their clients can trust them to deliver independent, high quality advice services.

Apart from lending our support in general terms to the proposed Standard, ISN would like to make submissions in relation a number of detailed aspects of your Exposure Draft Standard.

1. Operative Date

Given that there is some overlap between the matters proposed to be regulated by the Exposure Draft Standard and the FOFA reforms, it is probably a logical step to align the operative date of both. The new Standard would therefore not be operative until 1 July 2012. The latter operative date could also be justified given the operational, technological and risk management/compliance changes which would need to occur to meet the new requirements of this Standard.

2. Breadth of Standard

The Standard proposes a broad scope of application that goes beyond the reforms proposed in the FOFA package, including application to general advice services (not just personal financial product advice) and all product types including risk products.

Obviously the focus of the legal regulatory framework revolves around the regulation of financial product advice, which is consistent with the approach of other OECD jurisdictions. The FOFA reforms propose an approach which will further increase the legal minimum obligations for providers of personal financial product advice.

However, in order to create minimum standards appropriate for a profession, the draft standard appropriately proposes a broader application, including setting higher professional standards for advice on all product types as well as on general financial advisory services.

The breadth of approach proposed in this Standard is commendable and reflects the more evolved nature of the accounting profession when compared with the financial planning industry and the independence of the APESB.

3. Proposed Regulation of Acceptable Forms of Remuneration

The Draft Standard APES 230 proposes that the only acceptable form of remuneration for accountants providing financial advisory services is a true “fee for service” fee arrangement, which is defined to exclude not only commissions but also percentage based asset fees, production bonuses and other fees related to product sales of the accumulation of funds under management. The stringent regulation of acceptable remuneration is critical to ensuring that financial advisory services are uncompromised by any financial payment or other benefit.

ISN would commend the approach taken in paragraph 9.1 of APES 230 as the tolerance of ongoing advice fees are highly problematic and are not consistent with completely independent, professional financial advice services delivered exclusively in the client’s interests. Ongoing fees of any kind inevitably embed a serious conflict of interest in the financial advisory relationship and often lead to advice services being used for product distribution. In particular, ongoing asset based fees for advice obscure the full cost of advice, erode savings as cost escalates over time with assets, and create an incentive for advisers to recommend strategies or products that pay such fees over those that do not. Remuneration of advisers through asset based fees ensures that the adviser’s income remains dependent on the sale of a product. Indeed the inherently conflicted nature of asset based fee arrangements is reflected by the fact in the FOA Reform package, they will be banned where the advice involves geared investments or products.

In addition, ISN would commend the APESB’s proposal (in paragraph 9.2) to ensure that all accountants adhere to these higher standards by the implementation date, and renegotiate the basis of client charging

to remove existing conflicted forms of remuneration. Given that many existing advice fees continue indefinitely without what's proposed in paragraph 9.2, the negative effects of conflicted forms of remuneration would also continue. This could give rise to an additional perceived or actual conflict, that is, an accountant being reluctant to give advice which would disturb these conflicted forms of remuneration were they permitted to continue.

The Standard also proposes to prohibit the receipt of any soft dollar benefits in paragraph 10. ISN would support this prohibition, as any benefit received and retained by the provider of financial advice has the potential to seriously compromise or bias the advice. ISN particularly supports the concept that any benefit which the accountant derives from volume or scale should be rebated in full back to the client. Given the multiplicity of existing business models through which rebates, benefits or other payments can be made to providers of financial advice, ISN would urge the APESB to consider whether it is necessary to ensure the ban extends to receipt of any benefits by related parties who might influence the accountant. In addition, there are some arrangements whereby the benefits flowing in relation to volume based benefits are delivered by way of equity arrangements, and so it may be worthwhile considering whether the Standard should explicitly prohibit this type of arrangement.

The only type of fee arrangement which is consistent with delivering an independent, professional service in the client's best interests is a fixed or one off fee which is determined by the complexity of the advice, the required skills, knowledge and experience of the practitioner, and the risk and time involved in providing the service. ISN strongly supports the comprehensive and stringent approach taken by APESB with respect to banning the receipt of any form of conflicted remuneration. There is little point in addressing the more obvious form of conflicted remuneration (i.e. commissions) if others are permitted to continue.

This Exposure Draft Standard will ensure that accountants delivering financial advice adopt the higher professional standards applying to other fields of accounting, rather than permitting accountants who provide financial advice to deteriorate into the often structurally conflicted remuneration structures which typify the financial advice industry.

ISN is aware of the significant opposition to the Draft Standard by elements of the accounting industry, who advocate the watering down of the Standard so that it is more aligned with the proposed FOFA reforms. Clearly there are significant commercial arrangements which will be disturbed by the proposed APES 230. However, to ensure that financial advisory services delivered by accountants are highly professional and not biased in any way by receipt of payments from product providers, the requirements of the proposed APES 230 must be implemented in full.

4. Fiduciary Responsibilities of Members

ISN is supportive of the imposition of a fiduciary standard on accountants providing financial advisory services to clients. In particular, ISN believes that it is desirable to be clear that this requires accountants to put the client's interests first and to disclose any actual, potential or perceived conflict of interest, and to avoid or minimise to an acceptable level any actual or potential threat to the accountant's objectivity or professional independence caused by personal or business relationships.

ISN is particularly supportive of combining the imposition of a fiduciary standard with regulation of remuneration related conflicts. Unlike a fiduciary duty under general law where remuneration related conflicts can be overcome by gaining the informed consent of the client, in the area of financial advice, it is broadly accepted that clients are generally not capable of providing 'informed consent'. The finding of the PJC summarises this view concisely:

There are also limits as to the usefulness of disclosure, however clear and concise, in an environment where clients have already committed in their mind to their trusted adviser's chosen strategy.¹

In the relationship between accountant and client, which is typified by a significant knowledge asymmetry and generally an ongoing and trusting relationship, disclosure of remuneration related conflicts are an insufficient measure to ensure that advice is unbiased. In the face of the current industry practices, it is critical that the APESB's standards specifically require that remuneration related conflicts be avoided altogether.

5. Terms of the Financial Advisory Service

The proposed requirements of paragraph 6 set higher and more effective obligations on accountants than current or proposed legal requirements, in terms of providing a 'terms of engagement' letter to clients on an annual basis.

While the FOFA package includes a proposal to require financial advisers to gain annual client renewal of fee arrangements, paragraph 6.2 would put in place more effective and detailed disclosure of the specific engagement with the client. Unfortunately there remains a high level of client disengagement and inertia in relation to their financial affairs. Regular renewal of the terms of engagement with a client should over time lead to clients exercising greater control and interest in their relationship with their accountant adviser.

6. The Basis of Preparing and Reporting Financial Advice

ISN is supportive of the proposed requirements set out in paragraph 7. We believe that there are some particular aspects of the proposed obligations which are important in terms of ensuring a high minimum standard of advice.

Currently, too much financial advice is provided where the possible strategies and product range available to the adviser are limited by the commercial arrangements put in place by the dealer group or licensee. ISN commends paragraph 7.1(b) in requiring accountants to reveal their evaluation of alternative strategies which could reasonably be expected to meet the client's financial needs. This should give rise to better competitive analysis of the strategies and products which will service the client's financial interests.

¹ Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p87

7. Conclusion

In order to maintain very high professional and ethical standards, it is critical that any accountant who is providing financial advisory services be subject to a fiduciary duty and an obligation to avoid receipt of any payment which introduces bias and creates tension between the client's interests and the accountant's personal stake in the advice. The final version of the Standard should go beyond what is proposed for the legal regulatory framework and ensure that accountants are subject to more rigorous standards, to ensure that all financial advisory services delivered by accountants are in the client's best interests.

ISN strongly supports the proposed requirements of the *Exposure Draft APES 230 - Financial Advisory Services* and would urge the APESB to issue a Standard which sets rigorous and effective regulations for accountants providing financial advice.