

13 September 2010

Mr Channa Wijesinghe  
Accounting Professional & Ethical Standards Board  
Level 7, 600 Bourke Street  
Melbourne Vic 3000

## **PROPOSED STANDARD: APES230 – FINANCIAL ADVISORY SERVICES**

Thank you for inviting comment on the proposed Standard APES 230.

Johnston Rorke and our financial services subsidiary, JR Wealth Management, wish to make a submission to the board for your consideration.

### **Johnston Rorke**

Johnston Rorke is an accounting and advisory firm providing a full range of services to private and family controlled group and businesses, professional services firms and the individuals within those organisations.

Since forming in Brisbane in 1974, Johnston Rorke has grown to become a leader in our market. We have 14 partners and more than 120 staff. The firm consists of Business Advisory Services, JR Pharmacy, JR Superannuation, Taxation, Audit and Corporate Services. We also have specialist IT services – JR Bizlink and JR Spacelink, which provide accounting and management reporting to pharmacy clients.

### **JR Wealth Management**

JR Wealth Management is a new initiative of Johnston Rorke, having received our own Australian Financial Services Licence on 31 August 2010. The partners of Johnston Rorke have recognised the need to provide an independent service to clients of the firm that provides investment advice in the best interest of our clients. To maintain this independence, we have taken the additional time and expense to hold our own AFSL. We also saw the need to have complete transparency with our clients, and will not receive any trail commissions or rebates of fees from any product providers or third parties. However, our business model is to charge clients who are part of our core Portfolio Management Service and asset-based fee.

### **Our Submission**

We would be pleased if you would consider the following responses to the proposed ban from 1 July 2011 of percentage-based asset fees for members providing financial advisory services.

1. **Fee for service** – we agree that numerous providers of financial advice as well as many commentators incorrectly consider asset-based fees as fee for service. They are not. Fee for service refers to time based or job based remuneration models. The crucial difference providers of financial providers should be informing their clients about is whether they are “fee only”, “commission only” or a “mixture of fees and commissions”. We reject commissions as a conflicted source of remuneration for the provision of financial advice. We

fully support the provision of genuinely independent financial advice on a fee only basis. Although there are circumstances where a fee for service is appropriate in the provision of specific solutions for clients, we believe that a time cost fee for service has the potential to provide inefficient advice and encourage inefficiency. We do not believe a time cost fee for service is appropriate for the ongoing monitoring and management of client portfolios. In fact, when employing such a fee model for the ongoing monitoring of portfolios, it has the potential to create *conflicts of interest*. Stockbrokers charging clients brokerage based on the amount of turnover, or number of trades, have the incentive to increase the frequency of trading to generate higher brokerage. Similarly, members charging clients time cost fees may be incentivised to generate advice to improve their fees, rather than acting in the best interest of the client. The incentive that exists within asset based fees is to provide advice to improve the value of the client's investments. We note that the proposed Future of Financial Advice reforms propose that no asset-based fee should be charged on additional geared funds, which we agree with.

2. **Competitive disadvantage** - we do not understand why the Board wishes to impose a more onerous standard on accountants providing financial advice than others within the financial planning industry. Such a standard would place accountants at a permanent competitive disadvantage. We note that there is no evidence that accountants providing financial advice have been the cause of the numerous problems within the financial planning industry that have come to light over recent years. There have also now been numerous reviews of the industry and none have made the recommendation to abolish asset-based fees. Further, we note that the effective date of the proposed standards is 1 July 2011, 12 months before the proposed implementation of the numerous Future of Financial Advice reforms that will be mandated for all Financial Advisory Services providers.
3. **Fiduciary duty** - we fully support the move to an explicit fiduciary duty being imposed upon the providers of financial advice towards their clients. As accountants providing financial advice, this has always been our primary duty. However, we do not consider that an asset-based fee is inconsistent with fulfilling a fiduciary duty. On the contrary, an inherent risk in a time-based fee model is that a client may prevent their best interests being the dominant driver of advice by seeking to cut costs and not receive important advice. As discussed above, we believe that an incentive exists within time-based fees for member firms to generate advice that is not in the best interest of the client in an effort to increase fees, hence contravening the premise of acting within a fiduciary duty.
4. **Conflicted remuneration models** – we completely reject conflicted remuneration models in which the providers of financial advice are paid by product providers, administration providers or any party other than the client. We fully support remuneration models that are transparent, simple and easy to understand for the client. We also fully support transparent and simple performance reporting so that clients can see at a glance what value-added (if any) has been achieved by the advisors recommended asset allocation and/or fund and stock selection. Wherever possible, this should be performance

after-taxes and after all fees and charges. We do not however consider that a simple, sliding scale asset-based fee determined using a fair and reasonable estimate of the time and complexity of the advisory responsibility is in any way in conflict with the best interests of the client. Ultimately, the “fee” debate in our view must give way to the “value” debate in which clients are able to clearly assess both the costs and benefits of their financial advice and make their choice of financial advisor accordingly.

5. **Fixed asset based fees** – we are aware that fund managers frequently charge the same fixed level of asset-based fees regardless of scale and complexity and agree that there is a conflict in that business model which may encourage asset accumulation rather than asset performance. In the medium to long term however, the funds management industry is a competitive industry and an asset manager who underperformed would be expected to lose their funds under management and therefore their fee income.
6. **Scale and complexity asset based fees** – we consider that asset based fees that are tiered to reflect both the economies of scale in managing larger sums and set to reflect the complexity and time involved in the full asset allocation, portfolio construction, investment selection, investment implementation, investment administration, investment monitoring and investment reporting tasks (particularly if this is supported with timesheet records) meet all the requirements expected of our profession. In particular, we contend that such fees are consistent with our fiduciary duty towards clients, are consistent with the clients best interests and are consistent with our ultimate obligation that our profession has towards the public interest.
7. **Annual opt-in** – we note that APES230 proposes that members disclose and agree with the client the terms of the Financial Advisory Service, including the fees, on an annual basis. This is consistent with the proposed Future of Financial Advice reforms. Under this system, a discussion will be held annually with each client about the fees charged, and the clients will consider the value of the advice they have received each year. We agree with the transparency of this proposal, and believe that this will improve the clarity surrounding advice and the value of that advice across the industry. We believe that an asset-based fee in fact creates greater transparency, as it is difficult to accurately estimate the time required to provide timely, accurate and informed advice to a client over the ensuing 12 months.
8. **Client’s right to choose** – we believe that the provision of financial advice should be a collaborative process, with the adviser listening to the client being an imperative part of the advice process. Although as a business, our standard practice is to charge asset-based fees, we believe it is important to have flexibility. If a client would prefer to pay a time based or fixed fee, we should have the ability to provide for this. Likewise, if members practices were only permitted to offer time based fees, yet the client has a preference for an asset-based fee, member firms would be unable to service the client. The client would then seek the advice from a non-accountant based adviser.

9. **Future of Financial Advice** – the financial services industry is undergoing an unprecedented level of regulatory change. Following extensive reviews from the Ripoll report, the government has proposed numerous changes to the industry through the Future of Financial Advice. These recommendations do not propose a change to asset-based fees. We do not agree with the proposal that financial advice businesses attached to accounting firms should impose a more restrictive standard, in addition to all of the other mandated changes for the industry.

In summary, we respectfully request that the Board reconsider its proposal that accountants abolish all asset-based fees from 1 July 2011 in favour of a proposal *that asset based fees must be based on the scale and complexity of the financial advice to be provided*.

Please do not hesitate to contact me on 07 3222 8444 should you wish to discuss any of the points we have raised in our submission.

Yours faithfully  
Johnston Rorke

Nigel Fischer CA  
Partner