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The Chairperson
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15 October 2010

Dear Kate,

Response to Proposed Standard 230 – Financial Advisory Services

We appreciate the opportunity to respond to the Exposure Draft of Proposed Standard: APES 230 *Financial Advisory Services* (the "ED") as developed by the Accounting Professional & Ethical Standards Board ("APESB").

We are supportive of a market where there is confidence in the integrity of the financial planning industry and therefore commend the APESB for being proactive in undertaking work on a replacement for APS12. However we believe that the ED, as drafted, has far reaching and potentially unintended consequences. Furthermore, we have concerns in respect of the proposed effective date of the ED.

Our significant comments in respect of the ED are set out below.

1. Timing of the finalisation of the ED

The ED has been issued subsequent to the release of "The Future of Financial Advice" ("FoFA") information package by the Minister for Human Services, Minister for Financial Services, Superannuation and Corporate Law. The FoFA represents a comprehensive Government response to the recent Inquiry into Financial Products and Services in Australia by the Parliamentary Joint Committee on Corporations and Financial Services, which was set up in the wake of collapses. The Governments response is guided by two overriding principles:

- financial advice must be in the clients best interests – distortions to remuneration, which misalign the best interests of the client and the advisor, should be minimised; and
- in minimising these distortions, financial advice should not be put out of reach of those who would benefit from it.

The FoFA propose a range of reforms upon which stakeholders will be consulted and the exact nature of the reforms have not yet been finalised. Furthermore, it is noted that it is intended that the reforms in respect of

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conflicted remuneration schemes, advisor charging regimes and statutory fiduciary duty would apply from 1 July 2012.

Given the objectives of the FoFA, we believe that it would appropriate for the APESB to wait until the outcome of the Government consultation process is known. The process will result in input from a wide variety of stakeholders, including financial planners, product providers, users of financial advice and regulators. This will allow the reforms to be based on wider stakeholder input.

Furthermore, we are concerned of the impact of the APESB seeking to impose requirements which go beyond those in the FoFA. In addition, some of the proposals set out in the ED have the potential to impact organisations other than financial planners, for example product providers, therefore there is a need for some transitional provisions in the ED.

2. Fiduciary Relationship

Where a Member provides financial advice to a Client, the ED asserts that there is a fiduciary relationship between the Member and their Client. Based on the ED, this relationship will apply to all advice (both general and personal) provided by the Member. In contrast the FoFA, which also has the concept of a fiduciary relationship between Financial Advisors and their clients, limits the relationship to circumstances where Financial Advisors provide *"personal advice"* to *"retail clients"*.

In our opinion it is not appropriate to impose a fiduciary duty under which a Member would be required to consider the Client's best interests when providing "*general*" advice. General advice by definition cannot be specific to a Client's particular circumstances. For example where general financial product advice is provided for the benefit of a large group of users (such as potential investors in the case of a prospectus), it is impracticable and not appropriate for financial advisors to be held to have a fiduciary relationship with such users. Furthermore, we are concerned that the ED proposes that the fiduciary duty would extend to advice given to "*wholesale clients*". Wholesale clients by their nature are sophisticated and therefore, do not need to be afforded the same level of protection as "*retail clients*".

We do not believe that it is the role of a professional standard to impose or seek to define fiduciary responsibilities. This is a matter for the courts to determine. We note to date that the courts have generally emphasised the need to examine the specific nature of the relationship in order to determine whether that relationship is one where a fiduciary duty would exist. However, as there is currently no statutory fiduciary obligation imposed on financial advisors generally under the Corporations Act 2001 ("the Act"), the courts have avoided finding the existence of a fiduciary duty in circumstances where the parties have agreed otherwise.

In *Pilmer v The Duke Group (in liq) & ors* (2001)[1], the High Court held that the accountant/client relationship does not, of itself, impose fiduciaries duties upon the accountants. Whether an accountant or financial advisor is subject to a higher duty (fiduciary duty) to their client will depend on the circumstances of the relationship, the terms of the retainer and the position of the client.

In *ASIC v Citigroup* (2007)[2], the court held that, even though the nature of the relationship would have strongly pointed towards the existence of a fiduciary relationship, the letter of engagement expressly disclaimed a fiduciary relationship. As such, there was no fiduciary relationship.

We also note that the Government has indicated its intention to impose a statutory duty on financial advisors as part of the FoFA reforms. In defining the precise nature of such a statutory fiduciary duty, the Government has indicated it will consult with stakeholders both on the "best interests" of clients and on the "reasonable steps" that an advisor must take to discharge their fiduciary duty.

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[1] 180 ALR 249 (HCA)

[2] ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)[2007]FCA 963

We consider that the ED should not seek to broaden any fiduciary duty of financial advisors beyond that which applies under current law ahead of the Government's proposed reforms in this area. Accordingly we recommend paragraphs 4.1 and 4.2 should be deleted and appropriate amendments made to other sections (including paragraph 9.1) of the ED.

3. Definitions of Client and Financial Advice

We are concerned the current definitions of "Client" and "Financial Advice" are too broad and will result in both general advice to retail clients and advice to wholesale clients being caught by the ED which we do not think is the intention.

Client

We understand it is the intention of the ED to provide extra protection to retail clients who receive personal financial advice from financial advisors in the area of financial planning and wealth management.

Currently the ED makes no distinction between retail or wholesale clients - we believe this is a relevant distinction as the obligations placed on financial advisors in relation to retail clients should be greater.

We note that the Government is continuing to consult on the appropriateness of the current classification of retail and wholesale clients in relation to the FoFA, and believe consideration needs to be given to a similar distinction for the purposes of this ED.

We believe the definition of Client for the purposes of the ED should only extend to retail clients, as defined under the Act, rather than all clients of a Member.

Financial Advice

The proposed definition of Financial Advice is broader than both the current definition of Financial Advice under APS 12, and the definition of Financial Product Advice contained in the Act. As drafted, we believe it will result in certain services being classified as financial advisory, which may not have been the intention. An example is tax advice (which does not require an AFSL) and is specifically exempted from the definition of Financial Product Advice under the Act. Furthermore the definition of tax advice in the current APS 12 states "where the member is asked merely to provide tax advice to a client and is not undertaking any other financial advisory services then that member is **not deemed** to be providing advice as a financial advisor".

Other examples that appear to be unintentionally captured by the ED include:

- asset allocation advice (which is outside the exemption in Regulation 7.1.33A of the Corporations Act);
- advice to superannuation trustees with less than $10 million in funds under management;
- structuring, establishment, due diligence or valuation advice currently exempted under Regulation 7.1.29(3) (c) of the Corporations Act.

4. Remuneration

The current amendments to remuneration models are cause of concern in the following respect:

i. they are intended to be applied retrospectively which in many instances may be impracticable and have an impact on not only the financial advisor; and

ii. some of the proposals in respect the models go further than those proposed in the FoFA.

We do not believe it would be appropriate to have different rules applicable to financial advisors depending on whether or not they are a member of a professional body.

Summary

We do not believe the introduction of the ED should be earlier than the proposed Government reforms. To do so would create inconsistencies and uncertainties for Members subject to two sets of reforms.

In addition, we do not support the introduction of a "fiduciary duty" as currently proposed and believe any such duty should be consistent with that proposed under the FoFA.

We believe that the definitions of Financial Advice and Client need to be reviewed to ensure the ED does not capture (i) general advice provided to retail clients and (ii) advice provided to wholesale clients.

Finally we believe further consideration needs to be given to the proposed amendments to remuneration structures.

We would be pleased to discuss our comments with members of the Board or its staff. If you wish to do so, please do not hesitate to contact me on 02 9322 7288.

Yours sincerely,

Deloitte Touche Tohmatsu

Caithlin Mc Cabe
Partner