

AGENDA PAPER

Item Number: 2

Date of Meeting: 4 September 2018

Subject: Update on the Royal Commission and Financial Services regulations in key jurisdictions

Action required For discussion For noting For information

Purpose

To provide the Board with an update on:

- the key matters raised at the Royal Commission in round five covering superannuation, which has been reported in the financial press to date; and
- findings of the research into the financial services industry in the UK and the USA, specifically on the mechanism of fees charged by financial planners.

Background

APESB issued APES 230 *Financial Planning Services* (APES 230) in April 2013, with an effective date of 1 July 2014 apart from the sections relating to remuneration which became effective on 1 July 2015.

In December 2017, the Australian Government appointed The Honourable Kenneth Hayne AC QC to conduct a Royal Commission into misconduct in the banking, superannuation and financial services industry in Australia.

As part of the Board discussion in the June 2018 meeting on the impact of this Royal Commission, the Board requested that Technical Staff conduct research into financial services industry in the UK and the USA.

The scope of the Royal Commission

The Royal Commission is considering a broad range of matters in relation to the banking, financial services, and superannuation industries. As part of completing the inquiry, the Commissioner has been conducting public hearings which focus on specific aspects of the financial services industry. The scheduled public hearings, including the focus of each hearing and the case studies discussed, are set out in Table 1 below.

Table 1: Summary of the Royal Commission Public Hearings

Public Hearing	Focus	Case Studies
<p>Note. Rounds 1-4 are covered in agenda items 10 and 10(a) of the June 2018 Board Meeting.</p>		
<p>5 (6- 17 Aug 2018)</p>	<p>Superannuation</p> <ul style="list-style-type: none"> • How licensees fulfilled their duties to members of regulated superannuation funds and the extent to which structural or governance arrangements may have affected the fulfillment of those duties. • Related issues such as selling practices in relation to superannuation, the relationship between trustees and financial advisers, the current legal regime and the effectiveness of regulators. 	<ul style="list-style-type: none"> • Duties of RSE Licensees • Superannuation funds and Aboriginal and Torres Strait Islander members • The effectiveness of superannuation regulators
<p>6 (10 - 21 Sep 2018)</p>	<p>Insurance <i>[not released at the date of preparing report]</i></p>	<p><i>[not released at the date of preparing report]</i></p>
<p>7 (19 - 30 Nov 2018)</p>	<p>Policy questions arising from the first six rounds <i>[not released at the date of preparing report]</i></p>	<p><i>[not released at the date of preparing report]</i></p>

Matters for Consideration

(a) Royal Commission Update

Issues relating to superannuation

The Royal Commission has issued twenty-eight orders granting leave to appear to a range of industry and retail superannuation funds.

Lines of questioning have included the charging of fees for no service, including the decision to continue using “grandfathered” commissions paid to brokers; superannuation fund performance, in particular in relation to retail funds; the fee structure for funds, their transparency, and their impact on wealth accumulation; the reporting of expenses, in particular administration expenses for retail funds, and “other” expenses (which can reach up to 20% of total expenditure – for industry funds); and the fiduciary duty of trustees.

The potential impact from the Royal Commission on the Superannuation industry

The findings to date have been of concern to the community. There are a number of potential outcomes to the superannuation industry, including the following:

- Potential removal of commissions, including “grandfathered” commissions and other commissions not banned by *Future of Financial Advice (FoFA)*, such as those for mortgage or life insurance brokers;
- Increased regulation of super funds, potentially including the following:
 - Increased scrutiny of retail fund returns
 - Increased fee disclosure requirements

- Strengthening of disclosure requirements, with the view to make superannuation funds more easily comparable for members
- Strengthening of expense disclosure standards, with the view to open “other” and “administration” expense lines to scrutiny by members.

(b) *Research in respect of the financial services industry in the UK and the USA and specifically on the mechanism of fees charged by financial planners/advisers*

UK

The Financial Conduct Authority (FCA) is responsible for regulating the financial planning industry in the UK. Prior to 2013, Financial Planners could elect to charge on a fee-for-service basis or to receive income via commissions. However, since 2013, the Retail Division Review (RDR) outlawed commissions on advice relating to pensions, investments or retirement income products. The RDR is similar in structure and timing to Australia’s *FoFA* reforms, and, similar to *FoFA*, did not include reforms for mortgage or insurance brokerage commissions.

The regulations require that the fee-charging structure should be clear and disclosed to a client upfront and in writing, so they have the information in sufficient time to review before the advice process starts. The financial adviser must also agree and disclose the total charges the client will pay as soon as this is known. There can be an ongoing charge only in the case of providing ongoing service, for example regularly reviewing the performance of the client’s investments.

USA

The United States Securities and Exchange Commission (US SEC) regulates investment advisers in the USA, primarily under the Investment Advisers Act of 1940, and the rules adopted under that statute.

The Financial Planners in the US operate under either a fee-for-service or a commission-based structure, or a combination of both. Generally, only larger advisers that have \$25 million or more of assets under management or that provide advice to investment company clients are permitted to register with the Commission. Smaller advisers register under state law with state securities authorities. Although state-registered advisers are governed primarily by state law, several provisions of the Advisers Act and US SEC rules apply to such advisers.

Unlike Australia and the UK, the US has not specifically banned commissions for investment products. Financial planners are therefore able to utilise a fee-for-service model, a commissions-based model, or some form of hybrid if they so choose. However, there are certain professional bodies, notably the National Association of Personal Financial Advisors (NAPFA), who do require their members to be fee-only

Further details are provided in the material presented under Agenda Items 2(a) and 2(b)

Way Forward

The Royal Commissioner is scheduled to release an interim report of findings by 30 September 2018, with the final report to be released by 1 February 2019.

The findings in the report are expected to lead to changes in the financial services industry and most likely around remuneration practices, e.g., fee for service versus commissions. Technical Staff will continue to monitor the developments at the Royal Commission and consider any impact to APES 230 *Financial Planning Services*.

Staff Recommendation

The Board note and discuss the update on Round five of the Royal Commission, as well as research undertaken in respect of the financial services industry in the UK and USA.

Material Presented

Agenda Item 2 (a) Summary of articles relating to Round five of the Royal Commission;
and
Agenda Item 2 (b) Research into the financial services industry in the UK and the USA.

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