

## AGENDA PAPER

**Item Number:** 12.2

**Date of Meeting:** 7 September 2009

**Subject:** APESB's Submission to Parliamentary Joint Committee's (PJC) Inquiry into Financial Products and Services in Australia

**Action Required**

**For Information Only**

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### **Purpose:**

To provide an update on APESB's submission to PJC's Inquiry into Financial Products and Services in Australia.

### **Terms of Reference of the PJC inquiry**

On 25 February 2009 the Parliamentary Joint Committee on Corporations and Financial Services resolved to inquire into and report by 23 November 2009 on the issues associated with recent financial product and services provider collapses, such as Storm Financial, Opes Prime and other similar collapses, with particular reference to:

1. the role of financial advisers;
2. the general regulatory environment for these products and services;
3. the role played by commission arrangements relating to product sales and advice, including the potential for conflicts of interest, the need for appropriate disclosure, and remuneration models for financial advisers;
4. the role played by marketing and advertising campaigns;
5. the adequacy of licensing arrangements for those who sold the products and services;
6. the appropriateness of information and advice provided to consumers considering investing in those products and services, and how the interests of consumers can best be served;
7. consumer education and understanding of these financial products and services;
8. the adequacy of professional indemnity insurance arrangements for those who sold the products and services, and the impact on consumers; and
9. the need for any legislative or regulatory change.

## **APESB Submission**

APESB's submission focussed on the following matters consistent with APESB's mandate:

- *The role played by commission arrangements relating to product sales and advice, including the potential for conflicts of interest, the need for appropriate disclosure, and remuneration models for financial advisers;*
- *The appropriateness of information and advice provided to consumers considering investing in those products and services, and how the interests of consumers can best be served; and*
- *The general regulatory environment for these products and services.*

Refer to APESB's submission for APESB's analysis of the issues and proposed recommendations to the inquiry. Two of the key issues raised in the APESB submission relate to:

- (a) Whether financial advisers are acting in a fiduciary capacity;
- (b) Existing remuneration structures and conflicts of interest.

### **(a) Whether financial advisers are acting in a fiduciary capacity**

APESB submission noted that there needs to be greater differentiation of the various parties who provide what is generally termed 'financial advice'. These may cover:

- **Broker/Agent:** The financial adviser is authorised to act on another party's behalf. The financial adviser's conflict of interest should be fully disclosed.
- **Steward:** The financial adviser has agreed to act on another party's behalf – there is a basis of trust and confidence. The interests of the financial adviser should be aligned with those of the other party.
- **Fiduciary:** The financial adviser has accepted legal responsibility to act on another's behalf. The financial adviser can have no conflicts of interest.

APESB's submission stated that consideration should be given to the existence of a fiduciary relationship arising within some or all of these categories and that it would be most useful to consider the question of the fiduciary role of financial advisers, and to provide clarity about when financial advisers may be acting in a fiduciary capacity.

We note that ASIC in their submission to the inquiry recommended that the following changes would improve the quality of advice:

- (a) *Clarifying the standard of care for advisers by introducing a legislative, fiduciary style duty;*
- (b) *Requiring prominent disclosure of restrictions on the advice that can be provided by an adviser in marketing and promotional material.*

### **(b) Existing remuneration structures and conflicts of interest**

In APESB submission the existing professional standard APS 12 *Financial Advisory Services* was noted. In respect of remuneration, the leadership position taken in APS 12 by the accounting profession in 2005 was noted and the following key paragraphs were highlighted for the consideration of the PJC:

**APS 12 states:**

- ***a clear preference for the fee for service approach as being more consistent with professional independence (Paragraph 17.2);***
- ***When setting a fee for service a member needs to consider client requirements, statutory duties, levels of expertise and responsibility, degree of complexity, amount of time taken, and professional and financial risk associated with providing the advice (paragraph 18.5)***
- ***a mere standardised percentage basis applied to all funds under management is not a fee for service (Paragraph 18.4).***

We note that ASIC in their submission to the inquiry recommends that:

*“Commission remuneration can encourage advisers to sell products rather than give strategic advice and to recommend products that may be inappropriate but are linked to higher commissions. Remuneration based on funds under advice also encourages sales and borrowings. Disclosure appears to be an ineffective tool to overcome these conflicts.”*

*“This would mean that the following forms of remuneration would not be permitted, particularly in relation to personal advice:*

- (a) up-front commissions;*
- (b) trail commissions;*
- (c) soft-dollar incentives;*
- (d) volume bonuses;*
- (e) rewards for achieving sales targets;*
- (f) fee based on percentage of funds under advice.”*

One of the key factors in the corporate collapses noted in the inquiry is the unethical behaviour by some financial advisers which has been created by the existing sales driven remuneration structures in the industry. Accordingly, if the approach taken in APS 12 in respect of remuneration was adopted by the industry then it would go a long way towards minimising conflicts of interest and reducing unethical behaviour.

**Invitation to attend the PJC Inquiry**

APESB has received an invitation to give evidence to the PJC inquiry on 26<sup>th</sup> of August 2009 in Melbourne. Stuart Black, Peter Day and Channa Wijesinghe will be representing the APESB at this inquiry. The Board will be provided with an update on the outcomes of the meeting on the 7<sup>th</sup> of September.

**Material presented**

- APESB’s submission to the PJC Inquiry into Financial Products and Services in Australia

**Recommendation:**

1. That APESB’s submission to the PJC Inquiry into Financial Products and Services in Australia be noted;

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**Date:** 24<sup>th</sup> August 2009