



Ms Kate Spargo
Chairperson
Accounting Professional and Ethical Standards Board
Level 7, 600 Bourke Street
Melbourne VIC 3000

By E-mail: sub@apesb.org.au

Cc: CEOs of the 3 Accounting Bodies
alex.malley@cpaaustralia.com.au
andrew.conway@publicaccountants.org.au;
lee.white@charteredaccountants.com.au

Grant Thornton Australia Limited
ABN 41 127 556 389

Level 17, 383 Kent Street
Sydney NSW 2000
PO Locked Bag Q800
QVB Post Office
Sydney NSW 1230

T +61 2 8297 2400
F +61 2 9299 4445
E info.nsw@grantthornton.com.au
W www.grantthornton.com.au

7 September 2012

Dear Kate

Exposure Draft ED 03/12 of Proposed Standard: APES 230 Financial Planning Services

Grant Thornton Australia Limited (Grant Thornton) appreciates the opportunity to comment on the Accounting Professional and Ethical Standards Board's (APESB) ED 03/12 Proposed Standard APES 230. We are separately contributing to a proposed submission to be made by the accounting profession (Australian Public Policy Committee – APPC, which is constituted by the 3 Australian accounting bodies and the six major accounting firms that includes Grant Thornton).

Grant Thornton's response reflects our position as auditors and business advisers to listed companies, privately held companies and businesses, and their owners and managers.

Grant Thornton does not support the release of ED 03/12 APES 230 as an APES standard, as it imposes restrictions on receiving certain commissions from third parties that the Government after extensive public consultation, has decided are acceptable under The Future of Financial Advice (FoFA) legislation that was passed on 25 June 2012 and which applies from 1 July 2013.

It is noted that ED 03/12 states that the guiding principle in the FoFA reforms and ED 03/12 are derived from the 'Bests Interests of the Client' so we question why Parliament has accepted that certain commission based income meets this test when the APESB has taken a

counter view that is not shared by the significant majority of those that made submissions on an earlier APESB ED.

Our specific concern is Insurance products where the Industry practice is to remunerate on a standard percentage of the cost of the premium. Please refer to Appendix 2 for case study examples showing the impact on the personal risk protection clients Grant Thornton provides advice to. We note that the United Kingdom regulators recently reversed their policy on banning risk commissions because risk commissions were determined not to represent a conflict of interest. The 'Retail Distribution Review' RDR (the UK version of FoFA) accepted the key argument that, for risk business only, commissions are clearly aligned to the consumer interest. Advisers get a clawback if the customer lapses the policy - this means the adviser has a vested financial interest in ensuring that the customer is satisfied with their purchase over time. As a result, our understanding is that UK accountancy practices continue to provide risk advice on a commission basis to clients.

Grant Thornton in its 21 October 2010 submission to the APESB made a similar statement that it did not support the 2010 Exposure Draft, and whilst we note that the APESB has engaged in various consultations with constituents, the APESB has not consulted with Grant Thornton.

Our principle reason for not supporting ED 03/12 is that we do not believe that the APESB should impose additional requirements on the accounting profession that have already been extensively debated by and rejected by Parliament, unless there is clear support from the accounting profession that more stringent requirements should apply. To impose such additional conditions where clearly there remain strong differences of opinion within the accounting community, places the accounting profession at a clear disadvantage to those that are not structured as a 'Member in Public Practice', compared to those who are in the category of a 'Member in Business' or are not a member of the accounting profession and therefore are not regulated by the APESB. We note that section 3.2 of the Explanatory Memorandum state that a "...significant proportion of respondents to the initial Exposure Draft were of the view that professional services provided by Members in respect of insurance and mortgage broking should be excluded from the scope of the Exposure Draft." The lack of member support for the APESB proposals which some see as dictating how an accounting practice should be conducted, rather than applying globally accepted ethical requirements such as the existing APES 110 Professional Code of Conduct is telling!

Given that the ban on certain commissions only apply to a Member in Public Practice we believe that there is the real risk that some members will restructure their business operations so that they meet the exemption requirements on certain commissions as a Member in Business, or relinquish their membership of the accounting profession as they consider that Parliament has resolved this issue. Alternatively the accounting bodies may exempt their members from some APES 230 requirements as a matter of 'public interest'.

In particular:

- a Grant Thornton notes that the APESB has engaged in an extensive due process with various constituents following the submissions received on the 2010 Exposure Draft, although not with Grant Thornton. The Explanatory Memorandum (EM) to ED 03/12 acknowledges that there were differences of opinions expressed in the ED 02/10 submissions but no statistical details are provided. The absence of such statistical details might be seen by some to mask the intensity and significance of the differences of opinion, that in Grant Thornton's opinion result in this ED 03/12 not having sufficient support from those who provided submissions to the APESB, and a clear lack of support from the accounting profession that has to date been regulated through the accounting bodies support for APES standards.

Whilst Standards setting is not a popularity contest, having significant opposition to ED proposals does require careful analysis, and in the absence of strong support, Grant Thornton question whether the APESB does actually reflect and represent the public interest. In Grant Thornton's opinion, the Explanatory Memorandum does not adequately deal with this issue in a transparent manner, apart from one reference at 3.2EM to a 'significant proportion of respondents to the initial Exposure Draft were of the view that professional services provided by Members in respect of insurance and mortgage broking should be excluded from the scope of the Exposure draft...'. It is ironic that the APESB's defence is that 'all Financial Planning Services should be treated in the same way', given the exemptions to Members in Business!

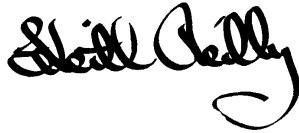
- b Whilst Grant Thornton concurs with Parliament and ED 03/12 that there should be a general ban on Commissions, we do believe that there are exceptions that do not threaten the APESB's 'incentive based remuneration' - conflicted remuneration (2.2 of the EM), and which have not resulted in reduced returns or losses to clients.
- c If the ban on commissions is considered so significant so that no safeguard can be applied in the Financial Planning Industry, why has the APESB not also banned such commissions for other areas that Members in Practice are involved in being: corporate finance, taxation, business broking and real estate where it is accepted industry practice to remunerate by publicly disclosed Commission based fees (EM 3.1)?
- d ED 03/12 incorrectly attempts to justify its stance on banning of Commissions by arguing it is consistent with the global and Australian equivalent APES 110 'Code of Ethics for Professional Accountants'. However APES 110 does not totally ban Commission based remuneration.
- e Grant Thornton accepts the challenges that some members in Business may have with ethical restrictions and this is mentioned in 3.3 of the EM with the reasoning that "...some Members may not be in a position to determine or change the policies of their employer. On that basis the Member in Business should ensure that their membership of one of the three accounting bodies does not apply in such situations and a statement to that effect on any document that they are associated with."
- f Grant Thornton does not support the retrospective nature of ED03/12. Parliament has made it clear that the ban on most Commissions applies to new products as from the application date of 1 July 2013. ED 03/12 bans such Commissions from

that date. Grant Thornton believes that such Commission should not be banned as in some instances it may be difficult to track who the former client is. A safeguard would be disclosure to the client if there is an on-going relationship.

- g Grant Thornton is firmly of the belief that the level and structure of fees is an issue that should be agreed between clients and their professional advisers, and that percentage-based fees can be a very appropriate form of remuneration where provided with transparency, full disclosure and within fiduciary obligations. Should the ban on asset based professional fees be implemented it would not allow appropriate differentiation between strategic advice and investment management advice. It would also not allow Grant Thornton to efficiently deal with the different types of clients who seek one or both of these advice services. We refer you to the case study provided in Appendix 1, which clearly highlights the significant practical issues as it relates to our business and the detrimental impact it would have on our Model Portfolio investment management service. We therefore encourage the APESB to reconsider its ban on professional fees expressed or collected as a percentage of the value of the client's assets or funds under management as detailed in section 8.2 of ED 03/12.
- h Grant Thornton notes the arguments for and against banning insurance and risk products in the 5.2 of the EM. In particular it is stated by those opposed to Commissions that non-stepped up Commissions have less churn risk and hence are not unreasonable. Surely this suggests that the safeguards which include disclosure outweigh the risks and hence the fundamental requirements to of both FoFA and ED 03/12 of being in the Best Interests of the Client have been met.
- i Legacy Products are a fact of life for a Financial Planning business and there are instances where the client has not been involved with the Financial Planning business for some time, or indeed is no longer identifiable, and Commission trailing Commissions are still paid. Grant Thornton believes that in those instances, there should be no ban on accepting such Commission on products that are sold to the Client before ED 03/12 was released. 6.3 of the EM could be read to allow receipt of Commission where the Client cannot be traced however Grant Thornton believes that this should apply to all Financial Products issued prior to the release of ED 03/12.
- j The APES 230 proposals to ban all Commissions does seem to be at odds with the business practice of the accounting bodies that promote various commercial products including life insurance, and state that Commissions are paid to the accounting bodies for any member purchases. Is the APESB publicly stating that the accounting bodies are in breach of their own APES 230 ethical principles? How ironic for members of the accounting bodies to be barred from accepting life insurance Commissions when the accounting bodies themselves see no reason to not accept such Commissions.

If you require any further information or comment, please contact me.

Yours sincerely
GRANT THORNTON AUSTRALIA LIMITED



Keith Reilly
National Head of Professional Standards

Appendix 1

Case Study: How Grant Thornton Wealth Advisory built an Investment Management offering that caters for all types of potential clients.

Summary

Firm: Grant Thornton Wealth Advisory Services Pty Ltd ('Grant Thornton')

Challenge: deliver a disciplined yet customisable process to portfolio administration, construction and review supported by a credible investment philosophy to reduce risk, increase efficiency and improve outcomes for all types of clients.

Solution: Grant Thornton partnered with Linear Asset Management Ltd ('Linear') to issue the Grant Thornton Private Wealth Account, a comprehensive portfolio management product registered with ASIC as a managed investment scheme under the Corporations Act. The Issuer and Responsible Entity of the Grant Thornton Private Wealth Account is Linear to which Grant Thornton (amongst others) provides Model Portfolios across the full range of asset classes.

Benefits: The Grant Thornton Private Wealth Account provides clients with a number of benefits including ease of administration, safe custody of assets, full transparency and reporting, effective tax management, flexible investment choice and diversification. Importantly it allows Grant Thornton to deliver a professional investment management service to all client types whether they be full service, limited advice, no advice or third party advised clients. Grant Thornton and/or clients can customise and blend Model Portfolios with legacy and self directed investments to provide a solution that truly caters for each client's unique financial circumstances.

Strategic Advice v Investment Management Advice

Grant Thornton's value proposition to clients (in summary) is to organise, protect and grow the financial resources of private Australian families. In providing these distinct services we charge a separate strategic advice fee and investment management fee.

The advice fee is how we are paid to develop the right strategies and structures for the client and the client's family's personal circumstances. Retirement planning, superannuation, debt management, wealth creation, gearing, risk management and taxation are all taken into consideration, documented and reviewed on an ongoing basis. For this we typically charge a fixed fee or similar 'fee for service' arrangement that is NOT related to funds under

management. However we are certainly not opposed to asset based fees for strategic advice either.

The investment management fee compensates our team of investment professionals for the time and intellectual capital required to build and maintain the highest quality model investment portfolios that best fit client's agreed structures and strategies. It also facilitates our due diligence and relationship management of the strategic partners that provide clients with access to exclusive domestic and global opportunities not available to retail investors. For this we charge an asset based fee which is detailed in the Grant Thornton Private Wealth Account Product Disclosure Statement (PDS) and which is consistent with the structure of all other Funds Management based businesses in the financial services industry. As the client examples demonstrate below this is critical to ensure we can deliver on the challenge outlined above to the range of clients we deal with.

Client Examples

- 1 **Full service Client:** a client who requests and receives full strategic advice as well as ongoing review and portfolio management.
- 2 **Limited advice Client:** a client who requests investment advice and ongoing management for a specific investment sum.
- 3 **General advice Client:** a client who does not wish to receive personal advice but wishes to invest in the Grant Thornton Model portfolios.
- 4 **Third Party advised Client:** a client who has received personal financial advice from a third party adviser who is not related to Grant Thornton, yet who invests in the Grant Thornton Model Portfolio which is made available on the Investment Menu of other badged or non badged Linear managed investment schemes.

The structure of the Grant Thornton Private Wealth Account and Model Portfolio service ensures it can be delivered to ALL client types above via a single Managed Investment Scheme allowing both clients and the Grant Thornton business to benefit from its teams robust portfolio construction process which has built an excellent track record. In example 3 and 4 above there is no 'financial planning service' provided and therefore absolutely no risk of conflict as it is the client and/or an independent third party adviser who is deciding on the level of investable assets to be placed in the product (and would appear outside the scope of APES 230 in any event). Whilst we acknowledge a potential conflict exists in example 1 and 2, we pride ourselves on delivering on our professional obligation to act in the best interest of the client. Remuneration has little to do with the concept of professional behaviour and we would therefore strongly refute the argument that a 'self interest threat' cannot be reduced to an acceptable level for clients 1 and 2. We note this is a view that is consistent with the view of the financial planning's peak industry body, the Financial Planning Association of Australia (FPA). In the FPA's FoFA Bill Tranche #1 and #2 submission dated 22 December 2011 it stated *"...to equate "asset based fees" with "conflicted remuneration" shows a profound (or potentially deliberate) misunderstanding of the fact that 'asset based fees' are not a form of remuneration at all, but very simply a form of 'calculating' remuneration. When coupled*

with the professional expectations that require client directed payment and prohibit product or strategy bias that act against a client's interest, it is clear that this form of calculation does not create conflict at all."

Should the ban on asset based professional fees be implemented, we seek guidance from the APESB as to how Grant Thornton can deliver its Model Portfolio service to the range of clients above without a significant restructure of its business and/or Private Wealth Account Managed Investment Scheme offering in which clients are currently invested and/or without being put at a competitive disadvantage to other providers of Model Portfolio investment management services.

In closing we also wish to make reference to the fact that in all the client examples above they could be retail or wholesale clients. We note FoFA continues to differentiate between retail and wholesale clients whereas APES 230 does not. In Grant Thornton's view this imposes an unnecessary cost on sophisticated/wholesale clients who would be required to receive a written advice document as per ED 03/12 section 6.8 and be charged for it on a fee for service basis (or have the cost absorbed by the financial planning business). Using the client examples above we note that under FoFA a wholesale client could make an investment without going through the full Statement of Advice process which certain sophisticated clients we deal with do not value or wish to be charged for.

Appendix 2

Case Study: Upfront and Ongoing Insurance Commission

Ban on upfront commission

With regards to the receipt of commission within a risk protection advice framework Grant Thornton are strongly opposed to being forced to offer our clients only one means of paying for our services. By allowing the risk protection advisers to only offer their clients a fee for service basis for their advice, should a commission basis suit their particular objectives they would be forced to seek advice with an alternative adviser not tied into APES 230.

This would put clients within accountancy practices at a disadvantage whereas if the risk advisers were able to offer clients a choice of fee structures within the initial client engagement and statement of advice stages the client could then select the most appropriate method for them. This must be preferable to having the accountancy based advisory firm impose one single remuneration offering on the assumption that it is best for the client. We feel that this would allow us to satisfy the risk needs of all our clients particularly those who are unprepared or unable to pay upfront service fees on top of the first month's/year's premium.

Case Study (The figures in this case study were obtained from AXA's Elevate quotation system)

A client, male, age 40, non-smoker requires protection advice resulting in a recommendation for \$1.5million of life & TPD cover for \$176 per month. We agree a fee of \$2,500 to arrange this cover.

By selecting a commission basis for adviser remuneration the premium would be \$176 per month. The client can satisfy our advice fee of \$2,500 via commission of approximately \$2,445 and therefore the client would be invoiced a further \$55. The first month's cost is \$231.

If the only available option were via rebating upfront commission and charging a fee for service the premium would be approximately \$141 monthly, a saving of \$35 per month however we would now invoice the client \$2,500. The first month's cost is now \$2,641.

It is inevitable that any client who is cash flow sensitive or values initial outlay over longer term benefit (bearing in mind the average policy is said to only last 4 years), would select the first option. As the proposal is for only one client charging offering, a significant portion of existing and potential clients will look elsewhere for their advice of risk protection.

We also note that the time it would take the savings in premium to offset the upfront service/advice fee would be 70 months or 5 years 10 months. This is nearly 2 years longer than the average lifespan of a life policy meaning the majority of clients would be financially worse off by paying initial advice fees, and this does not include the additional ongoing service fees that would be needed to be negotiated.

Ban on receiving on-going commission

Grant Thornton receives ongoing commission from risk protection products and use that total revenue pool to fund staff and advisers to service the ongoing support that its clients require, both in terms of advice and administration. This support can be ad hoc in nature. I.e. when there are administration issues or changes in circumstances or can be in the form of a formal annual review.

With the rebating of trail commission, should a client not agree to an ongoing service fee, who is responsible for advising the client on legislative changes that may impact them, who will assist the client in correctly changing ownership of policies, who will ensure that the outstanding annual premiums on policies are brought up to date when credit cards have expired, and who will assist the client with administrative errors caused by the insurance providers?

Currently these are the services provided by insurance advisers, but should ongoing trail commissions cease, for clients advised by risk advisers within accountancy practices, responsibility will have to fall elsewhere. During the 'Retail Distribution Review' RDR in the UK, the Association of British Insurers presented clear consumer research evidence that consumers will not pay fees for risk advice or ongoing service.

The impact will be a fracturing of the client service standards that accountancy practices are financially able to offer their risk protection clients. A small portion of clients will remain, having arranged an ongoing service agreement, however, the vast majority will not have access to an adviser at all for ongoing issues and advice.

In essence the main impact of this document would be to create a transactional culture with regards to risk advice within our profession.