

RAISING PROFESSIONAL AND ETHICAL STANDARDS OF FINANCIAL ADVISERS

Consultation on PJC Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry



May 7 2015

ABOUT INDUSTRY SUPER AUSTRALIA

Industry Super Australia (ISA) is a research and advocacy body for Industry SuperFunds. ISA manages collective projects on behalf of a number of industry super funds with the objective of maximising the retirement savings of over five million industry super members.

ABOUT AIST

The Australian Institute of Superannuation Trustees (AIST) is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds who manage the superannuation accounts of nearly two-thirds of the Australian workforce.

AIST provides professional training, consulting services and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

Please direct questions and comments to:

Ailsa Goodwin
Senior Manager – Regulatory
Policy, ISA
03 9923 7172
agoodwin@industriysuper.com

Lygia Engert
Legal Policy Analyst, ISA
03 9657 4317
lengert@industriysuper.com

Richard Webb
Policy & Regulatory Analyst,
AIST
03 8677 3835
rwebb@aist.asn.au

SUBMISSION – PROFESSIONAL CONDUCT AND STANDARDS

Contents

Executive Summary	1
ISA/AIST position on recommendations of PJC	2
1. Background	5
2. ISA/AIST response to recommendations	5
2.1 Renaming General Advice	5
2.2 The value of general advice	6
2.3 Renaming general advice won't solve the problem – conflicted remuneration	8
2.4 Replacing the term 'personal advice'	8
3. Recommendations relating to the register of financial advisers	9
3.1 Consideration of clearer labelling for financial independence	9
4. Recommendations relating to educational and professional standards	12
4.1 Key issues with proposed model	12
4.2 ISA/AIST's recommended modifications	14

EXECUTIVE SUMMARY

ISA and AIST welcome the opportunity to participate in consultation on the recommendations of the Parliamentary Joint Committee (PJC) on Corporations and Financial Services Inquiry to lift the professional, ethical and education standards in the financial services industry.

Access to high quality financial advice is increasingly important to every Australian due to compulsory superannuation, a greater number of consumers entering retirement and the increasing complexity of financial products. Unfortunately, a series of high profile advice scandals has destroyed public confidence and trust in the financial advice industry. These scandals are a legacy of an environment in which product issuers paid financial advisers to sell their financial products and an inadequate regulatory framework which failed to protect consumers from these conflicts of interest.

Industry SuperFunds have been vocal advocates for reforms to address these problems. We strongly supported the introduction of the Future of Financial Advice reforms, which introduced an obligation on advisers to act in the best interests of their clients, and a ban on many forms of conflicted remuneration. ISA and AIST strongly support an effective financial services regulator and enforcement framework, including adequate resourcing.

ISA and AIST also strongly support higher educational, professional and ethical standards for financial advisers. However, there are two fundamental problems with the model for increasing educational, professional and ethical standards for financial advisers proposed by the PJC:

- First, the proposal to allow professional associations representing advisers to establish Professional Standards Schemes that cap the liability of advisers for consumer losses will entrench the current situation under which many consumers who lose money as a result of poor quality advice receive little or no compensation. A limited liability model is not suitable for an industry where poor quality advice, often about a single product, affects multiple clients of a single adviser.
- Secondly, the model proposed by the PJC would hand responsibility for developing, implementing and monitoring higher standards to the same industry participants who strenuously opposed the FOFA reforms and ASIC's attempts to lift education standards. Self-regulation will not address the crisis of public confidence and trust in the financial advice industry.

ISA and AIST recommend a number of modifications to the model proposed by the PJC:

- Separating work on increasing education standards from the development of industry codes of conduct, and prioritising educational standards.
- A tripartite model for the composition of the Financial Planning Education Council that includes a more appropriate balance of consumer, academic and industry representatives.
- Harnessing the potential of the recently established ASIC Financial Advisers register as a vehicle to ensure compliance with higher standards.

ISA and AIST are supportive of increasing educational and professional standards, but wish to emphasise that the financial planning industry will not be able to achieve its ambition of being regarded a profession, while advisers can be paid conflicted remuneration. While the FoFA reforms introduced a ban on sales commissions, conflicted remuneration continues to be widespread as a result of extensive grandfathering as well as generous exemptions to the life insurance advice industry. If the Government is serious about ensuring that consumers can access professional and unconflicted financial advice, it should consider a complete ban on all types of conflicted remuneration.

ISA/AIST position on recommendations of PJC

Recommendation	ISA/AIST Position
<p>Recommendation 1</p> <p>The term 'general advice' in the Corporations Act 2001 be replaced with the term 'product sales information' to better reflect the nature of that information.</p>	<i>Do not support</i>
<p>Recommendation 2</p> <p>The term 'personal advice' in the Corporations Act 2001 be replaced with 'financial advice' to better reflect the nature of that advice.</p>	<i>Do not support</i>
<p>Recommendation 3</p> <p>That to provide 'financial advice' an individual must be registered as a financial adviser.</p>	<i>Support</i>
<p>Recommendation 4</p> <p>That the government should bring forward legislation to protect the titles 'financial adviser' and 'financial planner' and require that to be eligible to use the title 'financial adviser', an individual must be registered as a financial adviser.</p>	<i>Support</i>
<p>Recommendation 5</p> <p>That the register of financial advisers:</p> <ul style="list-style-type: none"> ▪ include the information fields detailed in the government's announcement of the register on 24 October 2014; ▪ have a unique identifier that follows every individual adviser throughout their career; ▪ only list financial advisers on the register when a professional association (which has been approved by the Professional Standards Councils) advises that the adviser has completed the requirements of the Finance Professionals' Education Council approved professional year and passed the registration exam; ▪ record any higher qualification awarded by a professional body to the adviser; ▪ annotate any censure or limitation placed on a financial adviser by a professional body, Australian Securities and Investments Commission or Australian Financial Service Licence holder; and ▪ highlight that an adviser is no longer authorised to provide financial advice if the adviser has their membership of the nominated professional body suspended or revoked. 	<i>Support with modifications</i>
<p>Recommendation 6</p> <p>That the government consider proposals to increase fees for organisational licensees to reflect the scale of their financial advice operations, in the context of a broader review of ASIC's fees and charges.</p>	<i>Support in principle</i>
<p>Recommendation 7</p> <p>The committee recommends that:</p>	
<ul style="list-style-type: none"> ▪ The mandatory minimum educational standard for financial advisers should be increased to a degree qualification at Australian Qualification Framework level seven; and 	<i>Support</i>

Recommendation	ISA/AIST Position
<ul style="list-style-type: none"> ▪ A Finance Professionals' Education Council (FPEC) should set the core and sector specific requirements for Australian Qualifications Framework level seven courses. 	<p><i>Support subject to additional recommendations about the composition of the FPEC</i></p>
<p>Recommendation 8 That ASIC should only list a financial adviser on the register when they have:</p> <ul style="list-style-type: none"> ▪ Satisfactorily completed a structured professional year and passed the assessed components; and ▪ passed a registration exam set by the Finance Professionals' Education Council administered by an independent invigilator. 	<p><i>Support</i></p>
<p>Recommendation 9 The government require mandatory ongoing professional development for financial advisers that:</p> <ul style="list-style-type: none"> ▪ Is set by their professional association in accordance with Professional Standards Councils requirements; and ▪ achieves a level of cross industry standardisation recommended by the Finance Professionals' Education Council. 	<p><i>Support</i></p>
<p>Recommendation 10 The committee recommends that the professional associations establish an independent Finance Professionals' Education Council (FPEC) that:</p> <ul style="list-style-type: none"> ▪ is controlled and funded by professional associations which have been approved by the Professional Standards Councils; ▪ comprises a representative from each professional association (which has been approved by the Professional Standards Councils), an agreed number of academics, at least one consumer advocate, preferably two who represent different sectors and an ethicist ▪ receives advice from ASIC about local and international trends and best practices to inform ongoing curriculum review; ▪ sets curriculum requirements at the Australian Qualifications Framework level seven standard for core subjects and sector specific subjects (e.g. Self-Managed Superannuation Fund services, financial advice, insurance/risk or markets); ▪ develops a standardised framework and standard for the graduate professional year to be administered by professional associations; ▪ develops and administers through an external, independent invigilator a registration exam at the end of the professional year; ▪ establishes and maintains the professional pathway for financial advisers including recognised prior learning provisions and continuing professional development. 	<p><i>Support with modifications</i></p>

Recommendation	ISA/AIST Position
<p>Recommendation 11</p> <p>The committee recommends that professional associations representing individuals in the financial services industry be required to establish codes of ethics that are compliant with the requirements of a Professional Standards Scheme and that are approved by the Professional Standards Council.</p>	<p><i>Do not support. Instead recommend that FPEC assume responsibility for code approval after the process of setting higher education standards is complete</i></p>
<p>Recommendation 12</p> <p>The committee recommends that financial sector professional associations that wish to have representation on the Finance Professionals' Education Council and to be able to make recommendations to ASIC regarding the registration of financial advisers, should be required to establish Professional Standards Schemes under the Professional Standards Councils, within three years.</p>	<p><i>Do not support</i></p>
<p>Recommendation 13</p> <p>The committee recommends that any individual wishing to provide financial advice be required to be a member of a professional body that is operating under a Professional Standards Scheme approved by the Professional Standards Councils and to meet their educational, professional year and registration exam requirements.</p>	<p><i>Support education standards for advisers</i></p> <p><i>Do not support Professional Standards Scheme</i></p>
<p>Recommendation 14</p> <p>Transitional Requirements</p>	<p><i>Do not support</i></p>

1. Background

Public confidence and trust in the financial advice industry has been destroyed by a series of advice scandals. The Financial System Inquiry (FSI) found in 2014 that the collapses of Storm Financial, Opes Prime, Westpoint, Great Southern, Timbercorp and Banksia Securities affected more than 80,000 consumers, with losses totalling more than \$5 billion, or \$4 billion after compensation and liquidator recoveries.

This estimate does not include losses from advice scandals at Macquarie Bank, Commonwealth Financial Planning, National Australia Bank and ANZ that are the subject of ongoing parliamentary and regulator scrutiny.

Raising educational, professional and ethical standards is necessary to rebuild confidence and trust in the advice sector and improve the quality of advice to acceptable levels. However, this is only part of the solution.

At the heart of the issue is conflicts of interest that incentivise financial advisers to sell financial products on behalf of product issuers, rather than provide high quality financial advice. These conflicts include the payment of commissions and other forms of conflicted remuneration, and the dominance of vertically integrated business models under which the banks own most financial advice dealerships.

While the FoFA reforms introduced a ban on many forms of conflicted remuneration, commissions continue as a result of extensive grandfathering and numerous exemptions. ISA/AIST reiterate the importance of a legislative framework that ensures conflicts of interest between product issuers and distributors are effectively managed or, preferably, eliminated.

An effective regulatory regime also depends on a high performing financial services regulator and enforcement framework. ISA/AIST strongly support adequate resourcing for the Australian Securities and Investments Commission, and stronger penalties for breaches of financial services laws.

2. ISA/AIST response to recommendations

2.1 Renaming General Advice

Recommendation 1: The term 'general advice' in the Corporations Act 2001 be replaced with the term 'product sales information' to better reflect the nature of that information.

ISA/AIST position: Do not support.

The Committee supports a change to the term 'general advice' for the following reasons:

- To ensure that it 'more closely describes the nature of the information communicated which as the FSI report highlights, often contains sales and advertising information'¹;

¹ Parliamentary Joint Committee on Corporations and Financial Services Inquiry to lift the professional, ethical and education standards in the financial services industry, page 22

- Increased consumer awareness of the fact that they are being sold a product may act as a defence against unwittingly accepting marketing as advice, thereby playing a valuable role in the system of defences.

This recommendation is problematic for the following reasons:

- It undermines the value of general advice by incorrectly assuming that all general advice is conflicted or acts as an inducement;
- it does not address the conflicts and structures that may influence the advice.

Instead, ISA/AIST recommend:

- Renaming sales activities that attract conflicted remuneration; and
- tightening the definition of general advice, so it excludes advertising and sales activities.

2.2 The value of general advice

General advice is an efficient way for super funds to deliver relatively simple, modular advice to a high volume of members facing similar issues.

Industry SuperFunds and other not-for-profit do not and have never paid commissions for general advice.

Renaming general advice as product sales information implies that all general advice is conflicted or serves as an inducement, when this is simply incorrect.

General advice encompasses a wide range of activities that are of value to consumers.

Industry SuperFunds provide a range of member services, usually to existing members, which fall within the general advice model. The following table summarises the broad range of general advice services offered by Industry SuperFunds. The label ‘product sales information’ is not accurate for this advice, which is typically provided to existing members and frequently has a strategic focus.

Table 1: Examples of general advice

Member service categorised as general advice	Benefit
Retirement planning seminars	Assists members with a range of issues including making additional contributions, understanding Centrelink benefits and income stream planning
Workplace seminars	Provides general advice regarding super covering issues such as making additional contributions, investment choice and insurance
Online calculators	Retirement income forecast/adequacy calculators, superannuation comparators, insurance calculators, contributions calculators
Call centres	Provides general advice on super usually to existing members
Newsletters and research reports	Provides general advice about how super works, contribution types, investment choice and insurance option

General advice about superannuation makes financial advice accessible to consumers who would otherwise be unlikely to obtain it.

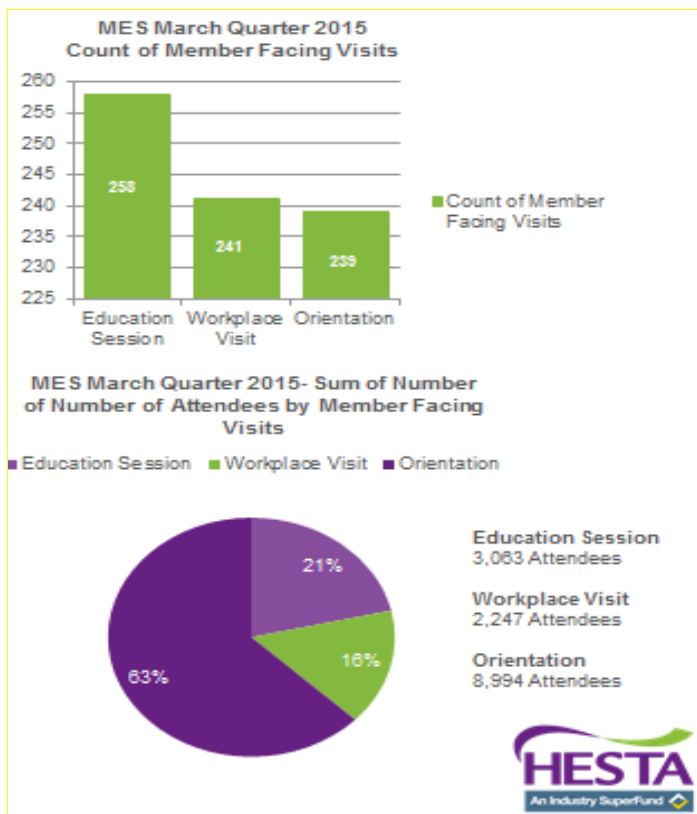
Industry SuperFunds have found that providing general advice often leads to members becoming more engaged with their super and seeking further personal advice.

General advice encompasses a range of topics and channels designed to meet the varied needs of members (See table 1).

The not-for-profit sector's business model for advice means that funds within the sector are well placed to offer a variety of types of general advice to their members.

Data provided by HESTA highlights the important role that general advice plays in their model for member engagement. In the 2015 March quarter alone, there were over 14,000 attendees at Member Facing Visits which comprise of Education Sessions, Workplace Visits and Orientation² for new members.

Figure 1: HESTA 2015 March Member Engagement – General Advice



Source: Hesta

² Talking to new staff on commencement of their new jobs

The variety of topics covered by general advice is highlighted in the following table which breaks down the categories of 18,152 general advice conversations by one advice service provider.

Table 2: Variety of topics covered by general advice

Category of general advice	Proportion
Investment Options (super & pension)	31%
Retirement Options (pension vs lump sum)	29%
Contributing to super	20%
Conditions of Release	8%
Insurance Options	7%

2.3 Renaming general advice won't solve the problem – conflicted remuneration

The fact that some activities which the current law categorises as general advice would be better described as product sales activities was identified by the Financial System Inquiry as well as the PJC, in an environment regulations had been introduced to wind-back key aspects of the Future of Financial Advice reforms. This included allowing the payment of commissions and other conflicted remuneration for general advice. These regulations were subsequently disallowed.

Despite this, commissions and other forms of conflicted remuneration continue to be permitted for general advice in certain circumstances. This includes grandfathered benefits as well as benefits for general advice about basic banking products, consumer credit insurance, general insurance products and life insurance.

To the extent that product sales activities that are remunerated by way of conflicted remuneration is still permitted, ISA/AIST agrees that there is a need to ensure that consumers are not misled into believing that they are receiving advice and understand that they are being sold a product by a sales person.

However, the PJC's proposal to relabel all general advice as product sales information will not achieve this valid objective. In particular, it would undermine the value of the useful general advice provided by Industry SuperFunds to members, and would not address the conflicts and structures that influence the advice provided by other financial services providers, particularly the banks.

ISA/AIST recommends that:

- The term general advice be retained for genuine advice including advice by Industry SuperFunds; and
- the term product sales information should be used for sales activities, including all activities that generate commissions as a result of grandfathering or exemptions from the ban on conflicted remuneration under FOFA.

2.4 Replacing the term 'personal advice'

Recommendation 2: The term 'personal advice' in the Corporations Act 2001 be replaced with 'financial advice' to better reflect the nature of that advice.

ISA/AIST position: Do not support.

ISA/AIST do not support relabelling general advice, and therefore do not support replacing the term financial advice. In order to meet the different needs of members it is important to maintain an advice framework that provides a clear distinction between general and personal advice.

3. Recommendations relating to the register of financial advisers

Recommendation 3: That to provide 'financial advice' an individual must be registered as a financial adviser

ISA Position: Support

Recommendation 5: Specific recommendations regarding items disclosed on register

ISA position: Support with qualifications

ISA/AIST support the Government's decision to establish a compulsory register for financial advisers as part of its commitment to lifting 'professional, ethical and educational standards across the financial advice industry'.³ While the register represents a move towards greater transparency for consumers, financial advisers continue to receive many incentives that influence and undermine the quality of advice. ISA/AIST believe that financial advisers should be required to disclose these incentives on the register.

While the reinstatement of FoFA bans many types of prospective conflicted remuneration, the legislation and grandfathering provisions include a number of very significant exemptions and concessions to various parts of the industry.

The banks strenuously opposed the FoFA reforms. Transparency of incentives is also necessary to safeguard against any possible future changes to the FoFA laws.

Given the significant impact that remuneration practices have on the quality of financial advice, a requirement to disclose the means by which an adviser accepts payment (remuneration options) would strengthen the functionality of the register as a tool for consumer protection.

Disclosure of any incentive is particularly relevant at the time a consumer is checking a financial adviser's credentials prior to engagement. Disclosure of such incentives serves two important purposes: firstly to create transparency for consumers, and secondly to encourage true fee for service charging by financial advisers.

3.1 Consideration of clearer labelling for financial independence

Nearly all of the financial advice industry in Australia works directly under, or is closely aligned with, major financial institutions and product providers.

ISA/AIST believe that there is merit in clearer labelling of financial planning independence. The Financial Advisor Register would be one mechanism to achieve clear labelling about adviser independence.

The register currently includes details of who controls the licensee that the adviser works for. However, it does not directly and clearly disclose whether the adviser is independent. Information about the entity that

³ <http://www.financeminister.gov.au/media/2014/0717-establishing-an-enhanced.html>

controls the licence is important, particularly for the regulator and commentators. It is less likely to be useful for consumers.

Research recently released by Roy Morgan reveals that there is significant consumer misconception of the independence of their financial adviser. In summary, around 10-15 per cent of financial planning clients of the major bank branded advice businesses believed their planner to be “independent”; while clients of planning businesses operated under separate brands (but still owned by the major banks) were perceived by around 40 per cent of clients as independent.⁴

However, it is not surprising that there is such poor consumer understanding of the issue – on top of generally low levels of financial literacy and engagement, there has to date been no significant explanation of or public attention given to the concept of independence, and disclosures of related party associations in regulatory documents such as Financial Services Guides are often vague.

The register represents the appropriate mechanism to provide consumers with this information.

Recommendation 4: That the government should bring forward legislation to protect the titles 'financial adviser' and 'financial planner' and require that to be eligible to use the title 'financial adviser', an individual must be registered as a financial adviser.

ISA/AIST position: Support

ISA/AIST strongly support the enshrinement of ‘Financial Adviser’ in legislation.

The definition of Financial Adviser should stipulate that to qualify to use the term financial adviser one must:

- Be recorded on the national register of financial advisers; and
- meet minimum education requirements, including a degree, an examination and a year of supervised professional practice.

Advisers should also be required to complete continuing professional development as a condition of registration. (See Table 3 for suggested timeframes)

Enshrinement will provide greater clarity on the role and responsibilities of financial advisers as well as a legal basis for the requirement of a higher minimum standard.

Recommendation 8: That ASIC should only list a financial adviser on the register when they have:

- ***Satisfactorily completed a structured professional year and passed the assessed components; and***
- ***passed a registration exam set by the Finance Professionals' Education Council administered by an independent invigilator.***

ISA/AIST Position: Support in principle

ISA/AIST support the recommendation that advisers should be required to meet these requirements in order to be registered by ASIC. As discussed in detail in our response to Recommendation 10, we do not, however, support the structure of the FPEC proposed by the PJC and instead recommend an alternative structure which provides greater independence from the advice industry.

In principle, ISA/AIST support the introduction of a registration exam for all financial advisers.

⁴ Roy Morgan, ‘Confusion with Financial Planner independence continues’, August 2014
<http://www.roymorgan.com/findings/5716-confusion-with-financial-planner-independence-201408040221>

With regards to the structure, rollout and requirements of the exam, we make the following general recommendations:

- In order to remain/become authorised to provide personal advice all advisers, existing and future, should need to pass an externally supervised exam;
- Mandatory competencies should include ethics and conduct;
- Content requirements of the exam should be set by a body that is independent of the advice industry;
- Different content requirements may be appropriate for different practitioners;
- The exam should take place in a supervised environment, not dissimilar to university exams; and
- The administration of the exam should be outsourced to an independent organisation specialising in the delivery of examinations.

Recommendation 12: The committee recommends that financial sector professional associations that wish to have representation on the Finance Professionals' Education Council and to be able to make recommendations to ASIC regarding the registration of financial advisers, should be required to establish Professional Standards Schemes under the Professional Standards Councils, within three years.

ISA Position: Do not support

ISA does not support this recommendation based on the arguments outlined in Section 3.

Recommendation 6: That the government consider proposals to increase fees for organisational licensees to reflect the scale of their financial advice operations, in the context of a broader review of ASIC's fees and charges.

ISA/AIST Position: Support in principle

It is critical that the regulator be adequately resourced to perform its functions. It is appropriate that fees for financial advice licensees with large scale financial advice operations reflect the risk associated with those operations and the level of regulatory scrutiny that must flow from that risk.

ISA/AIST agree that ASIC needs to be better resourced, and therefore better funded. However, AIST and ISA strongly agrees with the OECD that 'clarity about regulators' sources and levels of funding is necessary to protect their independence and objectivity. Transparency about the basis of funding can also enhance confidence that the regulator is efficient, as well as effective.'⁵ The OECD has noted funding sources may include consolidated revenue, cost recovery fees from regulated entities, monies from penalties, and interest earned on investments – and further that the mix should be appropriate to the particular circumstances of the regulator. To promote efficiency and equity, the IMF 1999 (as quoted by the OECD) states that the regulator should disclose why each funding source is paid in the way that it is.

In addition to this, we note that decisions regarding the financial levies charged via APRA have been made for several years on the basis that the Cost Recovery Guidelines published by the Department of Finance would be updated. We note our repeated submissions calling for the guidelines to be updated, with new guidelines not eventually issued until 2014. We also note that an inadequate Cost Recovery Impact Statement (CRIS) was released in 2014 to explain changes made to the funding model.

While ISA/AIST agree that ASIC does need to be better resourced, further debate around the method of funding is needed.

Further consultation is required in relation to the detail of changes to the fee structure relating to financial advice businesses.

⁵ OECD, (2013). *Principles for the Governance of Regulators*. Public consultation draft. [online] Paris: Organisation for Economic Co-operation and Development, pp.13, para 18. Available at: <http://tinyurl.com/ltpv73q> [Accessed 7 May 2015].

4. Recommendations relating to educational and professional standards

Recommendation 10: *The committee recommends that the professional associations establish an independent Finance Professionals' Education Council (FPEC) that:*

- *is controlled and funded by professional associations which have been approved by the Professional Standards Councils;*
- *comprises a representative from each professional association (which has been approved by the Professional Standards Councils), an agreed number of academics, at least one consumer advocate, preferably two who represent different sectors and an ethicist;*
- *receives advice from ASIC about local and international trends and best practices to inform ongoing curriculum review;*
- *sets curriculum requirements at the Australian Qualifications Framework level seven standard for core subjects and sector specific subjects (e.g. Self-Managed Superannuation Fund services, financial advice, insurance/risk or markets);*
- *develops a standardised framework and standard for the graduate professional year to be administered by professional associations;*
- *develops and administers through an external, independent invigilator a registration exam at the end of the professional year.*

ISA/AIST position: *Qualified support*

ISA/AIST support the establishment of a board to oversee professional and educational requirements for financial advisers.

However, ISA/AIST do not support the composition of the FPEC proposed by the PJC. We recommend modifying the structure to ensure that it is, and is perceived to be, independent of the advice industry. ISA/AIST strongly oppose allowing advisers to access caps on liability for poor quality advice through the Professional Standards Council.

4.1 Key issues with proposed model

The proposed model is problematic for the following reasons:

- It caps liability of advisers;
- It is not independent of the advice industry; and
- Undertaking parallel, inter-related processes to raise educational standards and develop codes of conduct is overly ambitious.

4.1.1 Liability caps

The PJC proposed that professional associations representing advisers establish Professional Standards Schemes that cap the liability of advisers.⁶ It is unsuited to an industry where poor advice to invest in a

⁶ The FSI found that collapses involving poor advice have resulted in consumer losses of \$5 billion, of which \$4 billion remains uncompensated. This does not include the scandals that have engulfed the financial planning arms of the banks including Macquarie, Commonwealth, National Australia Bank and ANZ.

particular product affects multiple clients of a single adviser if the product collapses or underperforms, and will not address the current crisis of public confidence and trust in advisers.

Instead, a liability cap would entrench the current situation under which consumers who lose money as a result of poor quality advice do not receive compensation.

The Financial System Inquiry found in 2014 that the collapses of Storm Financial, Opes Prime, Westpoint, Great Southern, Timbercorp and Banksia Securities affected more than 80,000 consumers, with losses totalling more than \$5 billion, or \$4 billion after compensation and liquidator recoveries.

This estimate does not include losses from advice scandals at Macquarie Bank, Commonwealth Financial Planning, National Australia Bank and ANZ that are the subject of ongoing parliamentary and regulator scrutiny.

ASIC's Consumer Advisory Panel commissioned research into the social impacts of investors suffering losses due to licensee misconduct. The research found:

For consumers who lost all their money and/or incurred debt, the financial impact of the loss was 'immediate and critical' and even 'catastrophic' and 'so significant their life will never be the same'. The impact on affected individuals included the loss of the family home, illness, strain in family relationships, and frugal spending on essentials. The study found the emotional wellbeing of affected consumers deteriorated with 'prolonged anger, uncertainty, worry and depression'. The study also found a subsequent lack of confidence in the financial system by those experiencing the loss.⁷

Evidence produced by the Financial Ombudsman Service (FOS) also demonstrates the inadequacy of compensation for victims of poor financial advice.

Even where FOS makes determinations for compensation, consumers do not always receive the compensation. For example, according to data published by FOS:

- In the investments, life insurance and superannuation area, the level of unpaid Determinations is 33 per cent of all Determinations made⁸
- 18 financial services providers haven't complied with determinations made by FOS in favour of consumers (1 January 2010 to 1 January 2014)⁹
- \$8,335,479.95 plus interest is owed to 99 applicants whose claims FOS upheld but who have not been paid compensation. Interest accrues at approximately 5 per cent per annum from the date of the award in most cases¹⁰

4.1.2 Lack of independence from the advice industry

The role of developing and administering increased educational standards must be performed by a body that is independent of the advice industry, as is the case for other professions.

The FPEC model proposed by the PJC comprises a representative from each professional association (which has been approved by the Professional Standards Councils), an agreed number of academics, at least one consumer advocate, preferably two who represent different sectors and an ethicist

The proposed model is essentially self-regulatory by handing responsibility for developing, implementing and monitoring educational standards to a board controlled and funded by industry participants.

⁷ *Compensation Arrangements for Consumers of Financial Services*, Final Report, Richard st John, April 2012, 2.165

⁸ <http://www.fos.org.au/the-circular-special-issue-april-2014/fos-forum/unpaid-determinations/>

⁹ <http://www.fos.org.au/the-circular-special-issue-april-2014/fos-forum/unpaid-determinations/>

¹⁰ <http://www.fos.org.au/the-circular-special-issue-april-2014/fos-forum/unpaid-determinations/>

ISA/AIST strongly caution against self-regulation due to the fragmented nature of the industry bodies in the financial advice sector, significant problems evidenced in the financial planning industry and the consumer detriment which it has caused, and the comparable models for setting and oversight of professional standards (even in 'mature' professions).

If self-regulatory models have proven inadequate to meet community and professional expectations in other mature professions, it must be recognised that the financial advice industry is a very long way from any form of self-regulation.

The weakness of self-regulation has been recognised by ASIC:

Self-regulation is an important part of the wider regulatory process. However, through our surveillance and enforcement activities, we have found that there are inherent issues in the practice. Considering our objective of providing greater certainty to industry and given the range of industry associations, self-regulation is unlikely to lead to a consistent understanding of the relevant obligations.¹¹

The advice industry strenuously opposed the FOFA reforms and ASIC's proposals to lift education standards for advisers. Self-regulation will not address the crisis of public trust and confidence in the advice industry which is a result of successive, high profile scandals.

4.1.3 Scope of new standards

While ISA/AIST support the increased focus on both educational and professional standards, the scope and transitional timelines recommended by the PJC are problematic.

Increasing educational standards for all personal advice on Tier 1 products, concurrently with a new professional association and code approval process will involve considerable industry activity and resources in a short time frame.

There is a significant risk that pursuing increases in both educational and professional and ethical standards at the same time will not deliver the meaningful increases in standards needed to rebuild public confidence and improve the quality of advice.

4.2 ISA/AIST's recommended modifications

ISA/AIST recommend modifying the PJC proposals to:

- Ensure that the composition of the FPEC is independent of the advice industry.
- Break the work of raising educational, professional and ethical standards into two phases. Raising educational standards for personal advice on Tier 1 products must be the highest priority and therefore should be tackled first.
- Abandon the proposal to allow the advice sector to access liability caps through Professional Standards Schemes approved by the Professional Standards Council.

4.2.1 Composition of FPEC

In order to effectively deliver the professional, ethics and education standards outlined in this submission, a strong governance framework is essential. The proposed composition for FPEC is outlined in Figure 2 below.

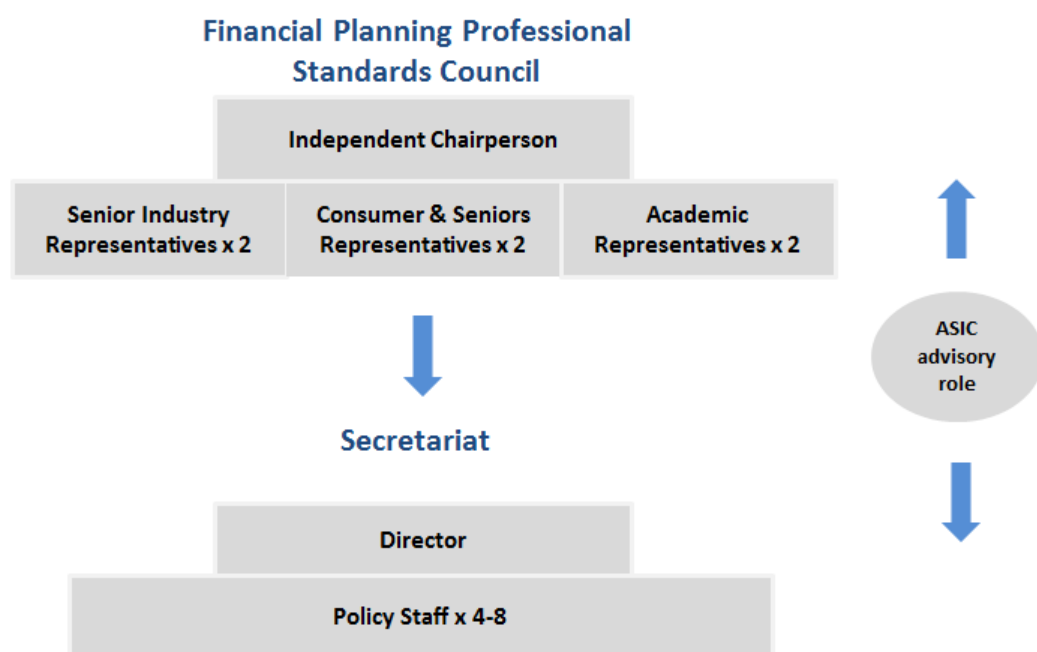
¹¹ ASIC, *Regulation Impact Statement: Future of Financial Advice: Best interests duty and related obligations*, December 2012

ISA/AIST recommend that a revised model of FPEC should:

- Be demonstrably independent of the advice industry;
- Contain a balance of people with relevant expertise;
- Consist of people with the skills to steer to the Council at a strategic level; and
- Be reviewed on a bi-ennial basis.

ISA/AIST believe it would be appropriate for ASIC to play a key role in the oversight and ongoing development of FPEC, and agree with the PJC's recommendation that the Council should receive advice from ASIC about local and international trends and best practices to inform ongoing curriculum review. The Council could be housed within ASIC, however with discrete funding and secretariat structures.

Figure 2 – Proposed structure for FPEC



4.2.2 Functions/Responsibilities

ISA/AIST recommend breaking the work of raising educational, professional and ethical standards into two phases. The amount of work involved in setting higher educational, professional and ethical standards is significant and should not be underestimated. Separating and prioritising these two work streams will allow industry to focus adequately on each in turn.

Raising educational standards for personal advice on Tier 1 products should be tackled first. Educational standards should be the first priority for reform because existing training standards for advisers are far too low and have never been revised since they were originally set as part of the FSR reforms. On the other hand, the ban on many forms of conflicted remuneration, and the obligation on advisers to act in the best interests of clients introduced as part of the FoFA reforms have gone some way to lift professional standards.

This phase of work would involve the following:

- (a) Setting minimum entry requirements for new advisers at degree level, including setting curriculum;
- (b) Approving relevant courses;

- (c) Developing the structure and content of a supervised professional year for new advisers;
- (d) Developing and delivering a national exam;
- (e) Setting standards and establishing a recognition of prior learning framework for existing advisers;
- (f) Setting continuing professional development requirements for all advisers;
- (g) Following completion of this, work should commence on developing industry codes of conduct. The composition of the FPEC should be reviewed and if necessary adjusted before work on codes of conduct commences.

Recommendation 14: Transitional Requirements

ISA/AIST position: Do not support

ISA/AIST’s proposed timeline for changes is outlined below. Each phase of this work will require formal consultation with a wide range of stakeholders.

Table 3 shows suggested timeframe for these phases.

Table 3 – Suggested timeframe for changes

Phase 1 Education	Proposed Date	Phase 2 Ethical Requirements and Approval of Associations	Proposed Date
<ul style="list-style-type: none"> ▪ Setting the minimum education and training standards for financial advisers 	Set by July 2016, applicable for all new entrants	<ul style="list-style-type: none"> ▪ Setting of approval framework for code/s of conduct 	Set by Dec 2016
<ul style="list-style-type: none"> ▪ Setting the structure and content of a supervised professional year for new advisers 	Set by July 2016 with commencement July 2017	<ul style="list-style-type: none"> ▪ Approval of code/s 	Dec 2016-Dec 2017
<ul style="list-style-type: none"> ▪ Structure, content and delivery of a registration exam 	Set by July 2016 with mandatory commencement for all advisers from July 2017	<ul style="list-style-type: none"> ▪ Requirement for all advisers to be subject to an approved code in order to be registered 	Commence January 2018
<ul style="list-style-type: none"> ▪ New standards and a recognition of prior learning framework for existing advisers 	Set by July 2016		
<ul style="list-style-type: none"> ▪ Continuing professional development requirements for all advisers 	Set by July 2016		

4.2.3 Registration as a compliance tool

There is great potential for the existing ASIC Financial Adviser Register to be used to enforce compliance with the educational and professional standards set by the FPEC.

Registration on the ASIC Financial Adviser Register should only be available to advisers who have met the minimum entry requirements, exam and professional year set by the FPEC. Ongoing registration should be conditional on completing continuing professional development requirements set by the FPEC.

4.2.4 Funding

The FPEC must be adequately funded to deliver its functions. As a starting point for discussion, we estimate funding of \$4 million per year is required for the first phase of work delivering higher educational standards. This would pay for a part-time Independent chair, a Director and 4-8 policy staff, depending on background and level of experience, and set up costs for the exam, although over time, ongoing delivery of the exam could be structured in a way that was fully self-funded. Consideration would need to be given as to whether the Council representatives would need to be salaried positions.

For instance, an annual budget of \$4 million equates to a cost of approximately \$200 per adviser based on the number of advisers currently registered on the Financial Advice Register.

Standalone funding for FPEC is required. It could be sourced as a per adviser charge for registration on the ASIC Financial Adviser Register.

As with the composition of FPEC, the funding arrangements should be reviewed, and if necessary adjusted, once this phase of work is completed and before FPEC commences its second phase of work on codes of conduct.

Further consultation is required to determine the detail of the funding model.

4.2.5 Review of FPEC

Once the FPEC has completed its first phase of work in relation to educational standards, it should be subject to an independent review to ensure that it is adequately resourced and performing its role to a satisfactory standard. The review should also determine whether any changes to the composition or funding of the FPEC are needed for it to undertake the next phase of its work.

4.2.6 Educational standards for advice on Tier 2 products and general advice on Tier 1 products

The changes to educational standards proposed by the PJC and ISA/AIST's recommendations in response relate to personal advice on Tier 1 products. This essentially covers advice about investment products, including superannuation, by financial planners other financial advisers.

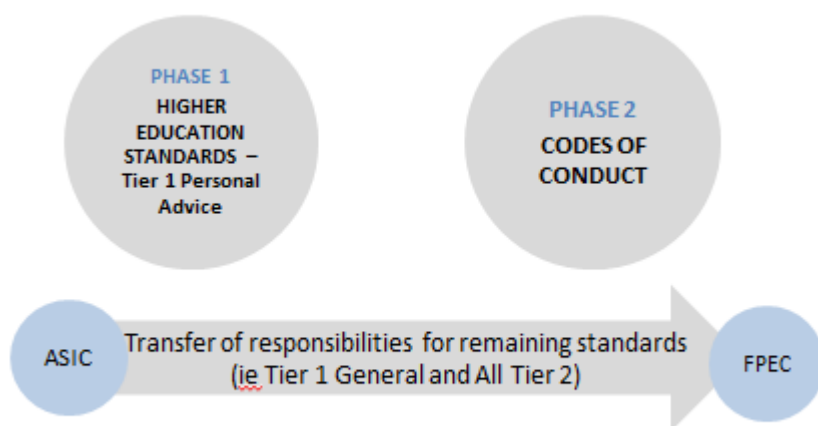
The PJC did not consider the existing educational standards for advice on Tier 2 products or general advice on Tier 1 products. ISA/AIST's view is that these standards, which have been set by ASIC and are set out in ASIC Regulatory Guide 146 *Licensing: Training of financial product advisers*, are adequate. ISA/AIST do not support changes to these standards at this time.

However, if the PJC's recommendations are implemented, the result will be dual regulation of educational standards in financial services: FPEC will be responsible for educational standards for personal advice on investment products, while ASIC will remain responsible for educational standards for general advice on Tier 1 products and all advice on Tier 2 products. It is not desirable to have the responsibility for

educational standards fragmented in this way. Nor is it desirable for licensees, particularly those who offer general and personal advice, including Industry SuperFunds, to be required to deal with two separate education regulators.

Therefore, ISA/AIST recommend that in due course, after FPEC has completed its work developing and implementing higher educational standards for personal advice on Tier 1 products, responsibility for administering the existing standards for other types of advice should be transferred from ASIC to FPEC.

Figure 3 Proposed transfer of standards from ASIC to FPEC



4.2.7 Codes of conduct and Professional Associations

Recommendation 11: *The committee recommends that professional associations representing individuals in the financial services industry be required to establish codes of ethics that are compliant with the requirements of a Professional Standards Scheme and that are approved by the Professional Standards Council.*

ISA/AIST position: *Recommend deferral of this phase of work until higher educational standards have been developed and implemented*

ISA/AIST agree that there is scope for codes of conduct to increase professional standards in the advice industry, particularly in relation to conflicts of interest and the ethical issues they create.

The amount of work involved in using codes of conduct to raise professional standards in the advice industry should not be underestimated. It would include:

- developing one or more industry codes of conduct with the aim of promoting uniformity
- establishing a code approval process
- managing the risk that a multiplicity of codes could lead to a ‘race to the bottom’ in terms of standard setting; and
- establishing the infrastructure necessary to monitor code compliance and resolve complaints.

For the reasons set out at 4.2.6, ISA/AIST’s view is that while worthwhile, this phase of work should be undertaken by FPEC, after FPEC has dealt with educational standards for personal advice on investment products, as a separate process.

Developing and implementing one or more approved industry codes of conduct would only be a worthwhile exercise if it results in a code or codes that raise standards beyond what is already required by law.

ASIC has the power to approve financial services sector codes under s 1101A of the Corporations Act. ASIC Regulatory Guide 183 *Approval of financial services sector codes of conduct* sets out ASIC's approach to and criteria for code approval. The threshold criteria used by ASIC in considering whether to approve a code are:

- (a) the code is enforceable;
- (b) broad stakeholder consultation has occurred and is reflected in the code;
- (c) the code addresses a broad range of issues of real concern to consumers;
- (d) it sets standards that elaborate on, exceed or clarify the law,
- (e) compliance with the standards enunciated in the code is monitored; and
- (f) remedies and sanctions are available for breaches of the code.

ISA/AIST's view is that the code approval process developed by FPEC should adopt these threshold criteria, and have regard to RG 183 more generally.

As noted above, it may be necessary to review the composition and funding of the FPEC to ensure that is adequately resourced to perform this function.

ISA/AIST support the development of one or more approved industry codes of conduct as a way of further increasing professional and ethical standards in the advice sector, particularly in relation to conflicts of interest. We support requiring advisers to subscribe to an approved code.

However, this work should occur after the increased adviser educational standards have been successfully delivered.

Recommendation 13: The committee recommends that any individual wishing to provide financial advice be required to be a member of a professional body that is operating under a Professional Standards Scheme approved by the Professional Standards Councils and to meet their educational, professional year and registration exam requirements.

ISA position: Support in part

ISA/AIST support compulsory education before advisers can be registered, however doesn't support the requirement that an individual providing financial advice must be a member of a body operating under a Professional Standards Scheme. See 4.1.1 and 4.1.2. However, as sponsors of approved codes advisers would eventually need to be a member of a professional body in order to be registered as noted above.