



Proposals to lift the professional, ethical and education standards in financial advice

Joint submission in response to the Parliamentary Joint
Committee on Corporations and Financial Systems Inquiry

September 2014

ABOUT INDUSTRY SUPER AUSTRALIA

Industry Super Australia 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 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.

As the principal advocate and peak representative body for the \$600 billion not-for-profit superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

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.

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SUBMISSION – PROFESSIONAL CONDUCT AND STANDARDS

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EXECUTIVE SUMMARY

ISA and AIST welcome the opportunity to respond to *the Parliamentary Joint Committee on Corporations and Financial Systems Inquiry* into proposals to lift professional, ethical and education standards in the financial services industry.

This submission does not address in detail all points of reference, but focusses on:

- The need to enhance education for financial advisers and recommendations to increase educational standards
- Barriers to professional and ethical standards for financial advisers and recommendations to improve these standards

While the Inquiry does not seek to examine the ‘broad evidence relating to poor performance and misconduct’¹, an examination into proposals to lift the professional, ethical and education standards in the financial advice industry should not overlook:

- The institutional ownership of the bulk of financial planning dealerships which raises the concern that financial advisers are compromised by the commercial imperative of selling and distributing the products manufactured by their parent or related party organisations
- The impact of winding back the Future of Financial Advice (FoFA) reforms and the removal of key consumer protections including the dilution of the best interest duty and the numerous exemptions to the ban on conflicted remuneration

ISA and AIST agree that increasing professional, ethical and education standards is a positive step towards professionalism, but strongly believe that this alone will not fix the structural tensions and regulatory gaps that have consistently failed to protect consumers.

We are therefore 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 and are not subject to a rigorous principles-based best interests obligation.

The recommendations outlined in this submission are summarised below.

¹ Committee Chair, Senator David Fawcett, Parliamentary Joint Committee on Corporations and Financial Services, Media Alert

Summary of recommendations

Section 1. Increasing education and training standards

ISA/AIST recommend:

- A minimum degree requirement for advisers giving personal advice. Consideration needs to be given to the rollout of this requirement, in order to create clear transition guidelines for existing advisers and those considering a career in advice
- A national exam for new and existing financial advisers with mandatory competencies including ethics and conduct
- A mandatory Continual Professional Development (CPD) requirement for all financial advisers
- Monitoring and supervision for all new financial advisers

Section 2. Improving professionalism within the industry

ISA/AIST recommend:

- Banning all forms of conflicted remuneration
- A principle-based best interest duty
- Establishing an enhanced public national register for financial advisers
- Making the adoption of a uniform code of professional practice and ethics or an approved code of conduct compulsory for all financial advisers. Any code must create higher standards, and operate in conjunction with, legislative conduct requirements. The code must be independently determined/ approved/ monitored.
- Enshrinement in law of the term financial adviser
- Clearer labeling for independent advisers

Section 3. Options for the oversight of improved education, professional standards

In order to deliver the above recommendations ISA/AIST propose two alternative options regarding the oversight of professional, ethical and education standards.

Option A

The establishment of a tripartite professional and competence standards body with responsibility for:

- Setting minimum education, training and professional standards for financial advisers (in line with recommendations in this submission)
- Creating a uniform compulsory code of conduct for all financial advisers
- Developing a national register for financial advisers

Option B

A co-regulatory approach to the development of professional, ethical and educational standards which includes:

- Approval of codes of conduct consistent with RG183
- Introducing higher minimum educational qualifications enforced by ASIC
- Developing a national register for financial advisers with oversight by ASIC

Self regulation as an option

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

SUBMISSION – PROFESSIONAL CONDUCT AND STANDARDS

1. Qualifications for financial planners

In recent years, financial advice has become increasingly important due to compulsory superannuation, a greater number of consumers entering retirement with substantial superannuation investments and the increased complexity of financial products.

A need to increase minimum training standards was one of the major recommendations of the *Ripoll Inquiry*, which found ‘the major criticism of the current system is that licensees’ minimum training standards for advisers are too low, particularly given the complexity of many financial products’². Evidence to the Committee ‘contended that the minimum training and qualifications for financial advisers should be raised’.³

A need to enhance education levels across the industry has been recently highlighted by:

- The Interim Report of the Financial System Inquiry
- The Final Report of the Senate Economics Committee Inquiry into ASIC
- Poor advice practices highlighted by high-profile financial collapses and the Commonwealth Bank Financial Planning scandal
- Surveillance undertaken by ASIC

For the reasons outlined below, ISA/AIST submit that the current qualifications required by financial advisers are inadequate in relation to personal advice, and should be raised.

1.1 Evidence supporting inadequacy of education and training standards

The *Interim Report of the Financial System Inquiry* highlights a need to increase professionalism in financial advice. Submissions to the Inquiry noted quality of personal advice as an ongoing problem,⁴ with the Committee citing relatively low minimum competence requirements applicable to financial advisers and varying standards of competence as key issues in advice.

The *Final Report of the Senate Economics Committee Inquiry into ASIC* found standards to be inadequate and recommended minimum education standards of a relevant university degree and three years’ experience over a five-year period for advisers, as well as minimum continuing professional development requirements.⁵ Following the Inquiry, the Commonwealth Bank announced new minimum education

² *The Ripoll Inquiry*, paragraph 5.76, 2009

³ *The Ripoll Inquiry*, paragraph 6.110, 2009

⁴ *Financial System Inquiry Interim Report*, 3-67, 2014

⁵ *Final Report of the Senate Economics Committee Inquiry into ASIC*, Recommendation 42

standards for Commonwealth Financial Planning Limited (CFPL) financial planners, supervisors and managers of planners.⁶ This has now been emulated by most of the major banks.

Research consistently demonstrates the need to raise professional and training standards in the industry. Shadow-shopping research⁷ by ASIC has found advice was ‘generally not of a sufficiently high standard’.⁸

Where advice was poor, common problems included:

- (a) Inadequately assessing or addressing the client’s personal circumstances, needs or objectives
- (b) Conflicted remuneration structures (e.g. product commissions and percentage asset-based fees) affecting the type of advice and recommendations, and the quality of advice given
- (c) Failing to provide adequate justification for recommendations, particularly when advising a client to switch products, where the new product was sometimes less advantageous to the client

These shadow shopping exercises reveal that many of the problems associated with poor advice result from conflicts of interest including the receipt of conflicted remuneration. However, adviser competence would certainly contribute to the standard and quality of advice delivered.

Shadow-shopping undertaken by ASIC also exposes the incapacity of consumers to assess the quality of advice that they receive, even where it is independently judged as being of a poor standard. Of 64 financial plans for retirement age individuals examined by ASIC, only 3 per cent of the financial plans were found to provide good quality financial advice, despite 86 per cent of participants believing they had received good quality advice and 81 per cent saying they trusted the advice they received from their adviser “a lot”.

Recent reports of advisers cheating on exams⁹, have shone the spotlight on whether the industry is adequately complying with the existing entry and ongoing continuous professional development requirements for advisers.

1.1.1 Comparison with other professions

ISA/AIST submit that the training standards for financial advisers providing personal advice needs to be raised to reflect the standards required by other professions.

The following table illustrates the stark contrast between the professional requirements for financial advisers and those for other professions.

Table 1 - Comparison of qualifications in other professions

Profession	Qualifications	Duration	Practical requirement
Financial Adviser	ASIC RG 146 Tier 1 products: Diploma Tier 2 products: Certificate III	Can be achieved in as little as 3 days	None
Engineer	Accredited program of study such as Bachelor of Engineering ¹⁰	4 years’ duration or longer ¹¹	None

⁶ Media Release, 18 July 2014, Commonwealth Bank Raises Educational Standards for Financial Planners

⁷ March 2012: see Report 279 *Shadow shopping study of retirement advice* (REP 279)

⁸ March 2012: see Report 279 *Shadow shopping study of retirement advice* (REP 279)

⁹ Adele Ferguson, Ben Butler, ‘Cheating rife in financial planning’, *The Age*, Saturday August 17

¹⁰ http://www.engineersaustralia.org.au/sites/default/files/shado/Education/Program%20Accreditation/140409_pe__last_updated_9_april_2014.pdf

¹¹ http://www.engineersaustralia.org.au/sites/default/files/shado/Education/Program%20Accreditation/140409_pe__last_updated_9_april_2014.pdf

Lawyer ¹²	Accredited law degree (generally Bachelor of Laws or Juris Doctor)	3 years for graduate 5 years for undergraduate	Course of study which provides practical legal training requirements for your intended state or territory of admission ¹³
Chartered Accountant	An Australian Accounting Bachelor or Masters degree with passes in subjects covering the core knowledge areas ¹⁴ then the Graduate Diploma of Chartered Accounting	3 years degree followed by Graduate Diploma of Chartered Accounting	Candidates must be complete 3 years (or part-time equivalent) in a relevant accounting role with an approved Training Employer and be mentored by an Australian Chartered Accountant or a member of another recognized Global Accounting Alliance body
CPA	A degree recognised by CPA in any discipline ¹⁵	3 years followed by the CPA Program (professional level)	Candidates must complete a minimum of three years' relevant full-time work experience or equivalent part-time work in a relevant role ¹⁶
Doctor	Approved program of study	4 years for post-graduate entry (with approved undergraduate course), 7 years for undergraduate entry ¹⁷	1 year internship before full medical registration plus additional requirements depending on area of specialisation
Dentist	Accredited program of study such as Bachelor of Dentistry ¹⁸	3 years for graduate with relevant degree, 5 years' duration or longer for undergraduate ¹⁹	None – practical element built into course

1.1.2 Comparison with other jurisdictions

In addition, there is a need for mandated improvement in training and conduct standards to bring Australia into line with comparable countries. For example, 'the United States, the United Kingdom, Canada, Singapore and Hong Kong all have national examination approaches to adviser competency'.²⁰ In the United Kingdom advisers must complete minimum annual ongoing training requirements of 35 hours as well as

¹² Each state and territory has different requirements and processes that are administered by their relevant admitting authority.

¹³ ACT: Legal Practitioners Admission Board ; Victoria: Council for Legal Education; WA: Legal Practice Board; Tas: Board of Legal Education; SA: Legal Practitioners Education and Admission Council; NT: Legal Practitioners Admission Board; NSW: Legal Profession Admission Board; QLD: Queensland Legal Practitioners Admissions Board

¹⁴ Note: This is the most straightforward entry pathway into the Chartered Accountants Program and accounts for around 75% of entrants. <http://www.charteredaccountants.com.au/Candidates/The-Chartered-Accountants-Program/Entry-requirements.aspx>

¹⁵ Note: Further study may be required if it is not an accounting degree <http://www.cpaaustralia.com.au/cpa-program/professional-level/structure-and-requirements>

¹⁶ CPA, *CPA Program: Practical Experience Guide*

<http://www.cpaaustralia.com.au/~media/corporate/allfiles/document/cpaprogram/practical-experience-guide.pdf>

¹⁷ Based on: http://sydney.edu.au/handbooks/medicine/medicine_at_sydney/medicine_at_sydney_index.shtml#combine; <http://coursesearch.unimelb.edu.au/pathways/3-medicine>

¹⁸ Accredited by the Australian Dental Council

¹⁹ <http://www.ahpra.gov.au/Education/Approved-Programs-of-Study.aspx?ref=Dental%20Practitioner>

²⁰ ASIC, *Financial System Inquiry: Submission by the Australian Securities and Investments Commission*, p 22

one year of supervised practice. In New Zealand, Authorised Financial Advisers must be registered on the Companies Office Financial Services Register (a process which includes uploading qualification documents), possess an authorisation to practise from the Financial Markets Authority and obtain the National Certificate in Financial Services.²¹

1.1.3 Review of current qualifications

RG146

Current qualifications for financial advisers are guided by ASIC in *Regulatory Guide 146 Licensing: Training of financial product advisers* (RG 146).²² These are minimum standards, which vary depending on whether the adviser is providing general or personal advice and the type of products the adviser is advising on.

Advisers who provide advice on Tier 1 (more complex) products must meet the standards at a different educational level from those advisers who provide advice on Tier 2 (simpler) products.

The minimum standard for Tier 1 advice is AQF Level 5, which is said to equate to a Diploma level of difficulty.²³ The minimum standard for Tier 2 advice is at a Certificate III level which is a basic entry-level qualification.²⁴

The knowledge and skill requirements and educational levels vary depending on the adviser's advice activities.

It is worth noting that while AQF level 5 does indeed refer to a diploma level of difficulty, minimum RG 146 compliance only needs to be a diploma subject or a package of diploma level competencies from an RTO that meets RG 146 compliance. There are additional competencies that need to be completed in order to meet the criteria for a full diploma of either financial planning or superannuation, but such additional requirements are not necessarily required for minimum RG 146 compliance.

With regards to continual professional development, RG 146 requires licensees to implement policies and procedures to ensure that licensees and advisers undertake ongoing training to maintain and update their knowledge and skills. There is no uniform standard by which all financial advisers must abide.

Notwithstanding the fact that the financial advice industry is relatively young, we submit that the training standard for financial advisers providing personal advice needs to be raised to reflect the standards required by other professions. We agree that the RG146 requirements for providers of general advice are appropriate but believe that the requirements for providers of personal advice should be substantially raised.

Certified Financial Planner Designation

The Certified Financial Planner designation offered by the Financial Planning Association (FPA) sets a higher standard of training for financial planners. Many Industry SuperFunds' advisers are Certified Financial Planners, however this is not a universal requirement.

Planners with this designation must hold an approved Degree/Masters/Doctorate; have studied CFP Program (post-graduate study); have completed three years' supervised experience; complete 120+ CPD

²¹ <http://www.fma.govt.nz/help-me-comply/financial-advisers/how-to-get-licensed/afa-application-resources-and-templates/afa-competence-and-assessment/>

²² Under the *Corporations Act 2001* (Corporations Act) Australian financial services (AFS) licensees must also comply with the conditions on their licence (s912A(1)(b)); (b) maintain competence to provide the financial services covered by their licence (s912A(1)(e)); and (c) ensure that their representatives are adequately trained and competent to provide those financial services (s912A(1)(f)).

²³ ASIC, *Consultation Paper 2012*, Licensing: Training of financial product advisers—Update to RG 146, para 101

²⁴ ASIC, *Consultation Paper 2012*: Licensing: Training of financial product advisers—Update to RG 146, para 116

points every three years with a prescribed ethics component; and signed up and be accountable to the FPA Code of Professional Practice.²⁵

ISA/AIST recognises that the CFP designation is a positive step towards increasing the professional standards for financial planners. In the future, some practitioners might choose to maintain their CFP designation in order to discharge future CPD requirements. However, in our view, education and professional designations should be independent of each other.

The setting of minimum entry and ongoing educational requirements and other professional standards must be universal and independent of any particular industry body. In the past, other professions including law and accounting have allowed industry bodies to take responsibility for setting professional standards. However, these mature professions have now shifted away from an entirely self-regulated model. Clearly, the FPA has taken a significant lead in working towards building professional standards including raised educational requirements for their members. However, an effective, uniform and enforceable minimum standard must be established through the development of one industry code or approval of professional standards and codes.

1.2 Recommendations to improve education and qualifications

Suggestions from various first and second-round submissions to the Financial System Inquiry to improve the minimum standard of education and professionalism required by financial planners include:

- Strengthening education and training requirements for advisers (especially for more complex Tier 1 products)
- Introducing a national exam for advisers
- Having an enhanced national register for advisers
- Enhancing ASIC's power to include banning individuals from managing a financial services business

In order to achieve consistent competence standards and greater transparency for consumers ASIC suggests:

- A national examination model to determine whether advisers have met a minimum standard of competency
- Mandated reference checking for all advisers who provide personal advice on Tier 1 products (i.e. the more complex products, in relation to which quality of advice is particularly important).
- A public register for all advisers who advise on Tier 1 products

ISA/AIST's recommendations to improve adequacy of education and training for financial planners are outlined below.

1.2.1 Proposals to lift the educational requirements in RG 146

ISA/AIST welcome the majority of ASIC's recent proposals outlined in *CP 212 Licensing: Training of financial product advisers— Update to RG 146*, June 2013, to increase the educational requirements in RG146 for advisers. Recommendations are divided into regimes (identifying staggered timeframes for rollout)²⁶ and include:

²⁵ <http://fpa.com.au/about-fpa/elevating-the-profession-a-letter-from-the-fpa-chairman>

²⁶ Regime B - new advisers who start providing advice on or after 1 January 2015 and before 1 January 2019 and advisers who completed their initial training under the current regime (i.e. Regime A) who, between 1 January 2015 and 31 December 2018,

- Tier 1 advisers complete an AQF Level 6 ‘Advanced Diploma’ for Regime B and an AQF Level 7 ‘Bachelor Degree’ for Regime C
- Tier 2 advisers complete an AQF Level 4 ‘Certificate IV’ for Regime B and an AQF Level 5 ‘Diploma’ for Regime C²⁷

ASIC’s rationale for these changes is:

The current training standards in RG 146 and consequent educational levels were set quite some time ago. As such, the review of the educational levels in RG 146 is timely, especially in light of the findings of the PJC Inquiry. In our recent shadow shopping study (REP 279), we identified training and professional development standards as one of the barriers to improving the quality of advice.²⁸

We support the critical role that RG146 plays in training and education, and improving the quality of financial advice and make the following comments with regards to ASIC’s recommendations.

Table 2 - ISA/AIST response to CP 212: Update to RG146

Proposal	ISA/AIST position
Degree requirement for practitioners providing a personal advice service	ISA/AIST support the requirement of a degree for advisers providing personal advice. We believe that consideration needs to be given to the rollout of this requirement, in order to create clear transition guidelines for those considering a career in advice
Degree requirement for practitioners who provide a general advice service	ISA/AIST does not support – We are of the view that current minimum requirements for general advice providers are sufficient. Increasing the minimum requirements for general advice staff would be likely to impact on the capacity of super funds and other providers to continue to offer general advice which currently benefits large numbers of consumers
Regime B as an interim measure	ISA/AIST do not believe that this rollout would add value, and would be a significant business disruption
Increased training as part of generic knowledge requirements	ISA/AIST broadly support this, but consider that the requirements for advisers providing general advice are smaller and should be removed from this list
Additional knowledge and skills mandatory for advisers who provide a personal financial product advice service	ISA/AIST support

1.2.2 Degree requirement

ISA/AIST support a minimum degree requirement for advisers giving personal advice. We believe that consideration needs to be given to the rollout of this requirement, in order to create clear transition guidelines for those considering a career in advice. We would be supportive of a reasonably short time-frame for the rollout, with new entrants required to meet this requirement by 2017.

decide to change their advice activities. Regime C - new advisers who start providing advice on or after 1 January 2019, advisers who completed their initial training under a previous regime(s) (i.e. Regime A and/or B) who, on or after 1 January 2019, decide to change their advice activities

²⁷ ASIC, *Consultation Paper 212: Licensing: Training of financial product advisers — Update to RG 146*, 2013

²⁸ ASIC, *Consultation Paper 215: Assessment and approval of training courses for financial product advisers: Update to RG 146*, para 107

1.2.3 National exam for new and existing financial advisers

The proposal to introduce a national exam for financial advisers has been delayed by ASIC to enable it to be embedded in the FoFA reforms. We are supportive of this measure, and would recommend further consultation regarding the content and transitional arrangements for its introduction.

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 an independent body
- The exam should take place in a supervised environment, not dissimilar to university exams
- The administration of the exam should be outsourced to an independent organisation who specialises in the delivery of exams

1.2.4 Monitoring and supervision for all new advisers

Currently there is no universal practical requirement for monitoring or supervision of new entrants into the financial advice industry. ISA/AIST recommend compulsory monitoring and supervision of new entrants into the industry by the licensee through mentoring or career transition programs. There should be some limitation on specialised area of practice during this period of supervision to ensure consistency of experience for new entrants into the industry.

1.2.5 Continual professional development requirements

ISA/AIST recommend that all financial advisers should be required to complete continual annual professional developments (CPD) which are set independently but could be overseen by the licensee they are operating under. At a minimum, compulsory CPD fields should include professional and technical skills, regulatory update, ethics and professional conduct, and practice management and business skills.

In ensuring that advisers meet these requirements, there may be merit in adopting a similar approach to that in the UK, which requires each individual financial adviser who sells investment products, securities or derivatives to have a current 'Statement of Professional Standing'. The Statement (which must be reviewed annually) indicates that they have completed at least 35 hours of professional training each year, signed up to a code of ethics and that they are up to date with changes in both industry and regulation.²⁹ The proposed Financial Adviser Register is the logical mechanism to record an attestation of completion of required competencies, including CPD.

2. Professional obligations owed by financial planners

ISA/AIST recognise that in response to public scrutiny in the aftermath of financial collapses and scandals, some businesses have demonstrated a growing commitment to improving standards, ensuring that conflicted forms of remuneration are phased out, and building the professional basis of financial planning.

²⁹ <http://www.unbiased.co.uk/ifa-qualifications>

Despite this, we strongly contend that the standards for professionalism required by financial advisers are inadequate and need to be enhanced.

Given the very significant failings of the industry and the potential for consumer detriment, there needs to be strong consumer settings in law and professional standards can build on this. True professionalism for financial advisers is no doubt hindered by the gaps in the current regulatory framework.

This is highlighted by:

- A heavily qualified legislative best interests duty
- Numerous concessions to the conflicted remuneration provisions which enable advisers to earn commissions, sales incentives and other benefits based on their advice
- The extent of vertical integration in the industry, particularly when combined with the availability of sales incentives and other forms of conflicted remuneration
- Poor advice practices highlighted by high-profile financial collapses

This section does not seek to provide an in-depth analysis of the implications for the competition and the cost of regulation for industry participants, but rather to illustrate the current barriers to financial advice being recognised as a true profession.

2.1 Barriers to professionalism

2.1.1 A poor public perception

Consumer attitudes towards financial advisers indicate that there is a long way to go before the industry can be regarded as professional.

Most notably, consumers do not appear to trust financial planners to provide them with unbiased, professional advice. Only one in three Australians (34 per cent) knows where to find a financial planner they can trust.³⁰ In a survey of 2409 participants, the poor perception and experience of financial advice was the most common reason (49 per cent) respondents would not look for a new adviser.³¹ A majority of consumers don't trust financial advisers and don't believe that advisers act in their clients' best interests.³² One of the main reasons for not seeking advice is the lack of trust they (consumers) have in financial advisers.³³

Industry perceptions of financial advisers are also low, with a survey of ASIC stakeholders finding that only a quarter of respondents agreed that financial advisers (23%) have integrity. An even lower proportion (20%) agreed that the industry manages conflicts of interest effectively.³⁴

³⁰ Financial Planning Association of Australia (2013), *Australians eager for financial advice*, Tuesday, 10 September 2013, <http://www.fpa.asn.au/default.asp?action=article&ID=23091>

³¹ Investment Trends (2013) *Advice & Limited Advice Report* September 2013, p 97

³² State Street and Center for Applied Research, *The Influential Investor: How investor behavior is redefining performance*, Nov 2012, p 20, quoted in ASIC (2012) *Future of Financial Advice: Best interests duty and related obligations*, Dec 2012, p 5

³³ Australian Securities and Investment Commission (2010) *REPORT 224 Access to financial advice in Australia*, Australia Government, Dec 2010, p 60

³⁴ Australian Securities and Investment Commission (2013) *Stakeholder Survey*, p 31

Low levels of engagement demonstrate a poor public perception of the industry, with industry modelling estimating that the proportion of the adult population receiving advice has fallen 20 per cent in the last five years.³⁵ At a national level, a 2013 survey of 1000 Australians found only 15 per cent of respondents to be using a financial adviser.³⁶

2.1.2 Inadequate legal framework

The current obligations imposed on financial advisers at law do not reflect an industry on the path to professionalism.

The original FoFA laws laid the foundation for a significant shift towards a more professional and impartial financial advice industry, however these laws were (at the behest of the major banks and elements of the financial advice industry) surgically diluted to remove all of the key new consumer protections, that had been in force less than 12 months.

On 30 June the Government released the Corporations Amendment (*Streamlining of Future of Financial Advice*) Regulation 2014, which became law on 1 July 2014. The Regulations put into law the Government's election commitments in relation to the dilution of key aspects of the FoFA laws, ahead of Parliamentary scrutiny of the legislative changes. Key windbacks include the dilution of the best interests duty and numerous exemptions to conflicted remuneration.

2.1.3 Heavily qualified best interests duty

The best interests duty was a key pillar of the FoFA reforms. The introduction of the duty was aimed at raising professional standards and by doing so, increasing consumer trust and confidence in financial advice.

Recent amendments have watered down the duty so that it does not require financial advisers to have to act in their client's best interests in order to satisfy the steps of the safe harbour.

The removal of 961B(2) (g) has reduced the best interest duty to a checklist whereby advisers may satisfy the duty without exercising any professional or independent judgement.

The recent regulations also enable planners and clients to "agree" on the scope of advice, provided the advice is "appropriate". This means that an adviser can limit the scope of advice through "client agreement", even if a reasonable adviser would know that the limited scope is not in the client's best interests. Problematically, under such an agreement, advisers can limit their advice to their employer's products irrespective of how uncompetitive those products are. The adviser does not need to warn the client about the impact of limiting the advice.

2.1.4 An environment clouded by commissions, incentives and other conflicted remuneration

Despite the widespread systemic problems with financial advice which continue to emerge, the regulations have re-allowed the payment of conflicted remuneration to financial advisers, despite the clear evidence

³⁵ Investment Trends (2013) *Advice & Limited Advice Report* September 2013, p 13

³⁶ Blackrock (2013) *Investor Pulse Survey*. This finding is consistent with other findings which survey financial advisers and accountants as separate categories. See for example ANZ (2011) *Adult Financial Literacy in Australia*, p 33, finds 18% of the 3500 surveyed adults had used a financial planner or adviser (not including accountants) in the 12 months to August, 2011, and the Investment Trends *Advice & Limited Advice Report* September 2013, estimates 14%, p 13

that such payments compromise the quality of financial advice and consumer outcomes. Worryingly, the regulations allow for conflicted remuneration to be paid on advice on complex products like super, debt products and managed investment schemes.

This measure compromises the stated objectives of the reforms: to remove the potential for conflicted payments to bias advice, to raise the quality of advice and to improve levels of consumer confidence and trust in advice.

The current laws permit many forms of conflicted remuneration:

- The general advice exemption, which provides significant scope for advisers to circumvent the ban on commissions and conflicted remuneration, even on complex products
- Permitting commissions to be earned on execution services by having a different adviser execute or implement the advice that another adviser initially provided
- Allowing commission-based bonuses to be paid to bank financial advisers via 'balanced scorecards'
- Allowing banks to pay commissions on all basic banking products extending the already broad exemption for basic banking products so that it applies for all staff including financial planning staff
- Permitting ongoing asset-based fees indefinitely
- Extending grandfathering so commissions can be traded – advisers can continue to receive grandfathered commissions without client approval when they move between licensees
- Permitting commissions to be automatically transferred from a client's super product into a new pension product with the same provider
- Creating an exemption for "permissible revenue" to enable commission-based bonuses to be paid
- Allowing banks to pay wholesale commissions to advisers based on volume of sales

The detrimental impact of commissions on advice has been recognised by the *Interim Report of the Financial System Inquiry* which found that 'the principle of consumers being able to access advice that helps them meet their financial needs is undermined by the existence of conflicted remuneration structures in financial advice'.³⁷

For as long as the financial planning industry tolerates conflicted remuneration they will not be regarded as a true profession and will increase the likelihood and risk of poor advice and further consumer losses.

2.1.5 Absence of uniform codes of conduct

At law there is no uniform professional code for financial planners, which is a feature of other "mature professions". Unlike professions such as medicine and law, which have nationally uniform codes, financial advisers may subscribe to a number of codes of varying quality, or no code at all.

The Australian Law Council has recognised that 'nationally uniform professional conduct rules are an important step toward creating a national legal profession in Australia'.³⁸ Obligations required by the code include: to act in the best interests of a client in any matter in which the solicitor represents the client; be honest and courteous in all dealings in the course of legal practice; deliver legal services competently, diligently and as promptly as reasonably possible; avoid any compromise to their integrity and professional independence; and to comply with the law.³⁹

³⁷ *Interim Report Financial System Inquiry*, 2014 p 1-20

³⁸ Australian Solicitor's conduct rules, p 3

³⁹ Australian Solicitor's conduct rules 4.1.1, 4.1.2, 4.1.3, 4.1.4, 4.1.5

Doctors in Australia must observe Good Medical Practice: A code of conduct for doctors in Australia.⁴⁰ Again, uniformity is a key element of the code, in that it complements the Australian Medical Association Code of ethics and is consistent with the Declaration of Geneva and the International Code of Medical Ethics, issued by the World Medical Association.⁴¹

The obligations include guidelines on recognising conflicts of interest⁴²; financial and commercial dealings including being transparent in financial and commercial matters relating to work⁴³ and recognising that there is a power imbalance in the doctor–patient relationship, and not exploiting patients physically, emotionally, sexually or financially.⁴⁴

According to ASIC, codes of conducts should improve consumer confidence in a particular industry or industries.⁴⁵ ISA/AIST believes that voluntary codes do not provide adequate protection for consumers from conflicts of interest, poor quality advice and conflicted remuneration.

While we are supportive of all financial planners on the financial adviser register ultimately being subject to an independently determined or approved code of conduct, and this should be separate to membership of a professional body.

2.2 Recommendations to improve professionalism

The Inquiry has specifically requested views on the implications for competition and the cost of regulation for industry participants of the financial advice sector being required to adopt professional standards, and the professional regulation of such standards. This submission does not seek to address this point in detail but strongly believes that the cost of regulation is far outweighed by the end benefit to consumers and the advice profession. The following suggestions outline key recommendations to improve professionalism.

Over time, increased professionalism might allow for calibration of the regulatory framework. However, it must be acknowledged that the provision of advice and product recommendations will necessarily always require rigorous legal regulation to ensure efficient and competitive markets as well as ensuring appropriately high levels of consumer protection.

2.2.1 Establishing an enhanced public register for financial advisers

ISA/AIST support the Government's decision to establish a public register for financial advisers as part of its commitment to lifting 'professional, ethical and educational standards across the financial advice industry.'⁴⁶

Such a register will provide ASIC and consumers with transparency about advisers' qualifications and employment history. The register will not only enhance ASIC's capacity to monitor financial advisers (including employee advisers) but will enable the benchmarking of key metrics in financial planning in its progress towards professionalism.

⁴⁰ <http://www.medicalboard.gov.au/Codes-Guidelines-Policies.aspx>

⁴¹ <http://www.medicalboard.gov.au/Codes-Guidelines-Policies.aspx> 1.1

⁴² <http://www.medicalboard.gov.au/Codes-Guidelines-Policies.aspx> 8.11

⁴³ <http://www.medicalboard.gov.au/Codes-Guidelines-Policies.aspx> 8.12.5

⁴⁴ <http://www.medicalboard.gov.au/Codes-Guidelines-Policies.aspx> 3.2.6

⁴⁵ ASIC, *Regulatory Guide 183: Approval of Financial Services Sector Codes of Conduct*, March, 2013, p 4

⁴⁶ <http://www.financeminister.gov.au/media/2014/0717-establishing-an-enhanced.html>

If correctly implemented, this initiative serves to:

- Create transparency of the industry's progress towards professionalism
- Empower consumers to make informed decisions about financial advice

The Government has committed to ensure that 'people saving for their retirement or managing financial risks through life can access high quality advice they can trust and which is also affordable'⁴⁷. In order to deliver this objective, we believe that the register should contain the following elements:

- Name of financial adviser
- Address of financial adviser
- AFSL Licence they operate under
- Qualifications
- Employment history (at least 10 years should be provided)
- Disqualifications, banning orders or professional misconduct rulings
- Means by which adviser is remunerated
- Associations and relationships with other entities that might influence the advice
- Whether adviser meets the definition of independent in s923A in the Corporations Act 2001

Other considerations:

- Ideally, the language and format of the register should be simple and standardised and include a link to the FSG
- The search function should allow consumers to search for the firm or individual representative

In particular, given the significant impact that remuneration practices have on the quality of financial advice, we believe that it is critical for the register to provide a summary of the means by which an adviser accepts payment (remuneration options). This information is relevant at the time a consumer is checking a financial adviser's credentials prior to engagement.

Over time, the register could replace the requirement to provide an FSG and would provide more user-friendly, concise, comparable information regarding all financial advisers.

There have been some calls to review the current definition of "independence" in s923A to lower the bar for those who wish to use the term in the context of their advice businesses. We are not supportive of any reductions of the definition of independence.

2.2.2 A high standard for codes of conduct

ISA/AIST recommend that all financial advisers are subject to a compulsory, uniform or approved professional standards/code.

ISA/AIST supports *ASIC Regulatory Guide 183* as providing a sound basis for the approval of codes of conduct which would facilitate a higher standard of professionalism and agree with ASIC's observation that 'an approved code responds to identified and emerging consumer issues and delivers substantial benefits to consumers'⁴⁸.

⁴⁷ <http://www.financeminister.gov.au/media/2014/0717-establishing-an-enhanced.html>

⁴⁸ ASIC, *Regulatory Guide 183*, 2013, p 4

RG 183 sets out key processes for the development of 'codes of conduct' and the core rules codes should cover.

Processes that should take place at the development stage include:

- Identifying at the outset all relevant stakeholders, including: affected consumers, relevant community and consumer groups, industry participants and their peak bodies, and relevant regulators and government departments
- Effectively consulting with all stakeholders to identify the issues and debate appropriate responses. For example, this may include obtaining information about consumer complaints from a variety of sources including internal and external dispute resolution complaints data
- Adopting transparent procedures (e.g. issuing a discussion paper, recommendations and/or a draft code for public consultation purposes). In most cases, it will be necessary to appoint an independent party to conduct public consultations and/or to make public recommendations about the code
- Having the early and appropriate involvement of ASIC and other relevant regulators in the development and consultative process
- Assessing whether a code actually provides the best option to address the identified problems; and resolving what is in (and out) of the code without bias towards any group of stakeholders⁴⁹

Core rules, are defined as 'the substance of any code, and the main vehicle for improving industry practices'⁵⁰. Core rules should address 'existing and/or emerging problems in the marketplace, rather than merely restating the law'.⁵¹

We support the current guidelines in relation to code administration and enforcement. Of particular importance are:

- Enforcement: At a minimum, available remedies for code breaches should include: (a) compensation for any direct financial loss or damage caused to an individual by the breach of the code; and (b) the ability to make binding non-monetary orders obliging the subscriber to take (or not take) a particular course of action to resolve the breach⁵²
- Administration: For a code to work effectively, there needs to be a person or body charged with overseeing the operation of the code that: (a) is independent of the industry or the industries that subscribe to the code and provide the funding (e.g. with a balance of industry representative and consumer representatives and an independent chair); and (b) has adequate resources to fulfil the relevant functions and to ensure that code objectives are not compromised⁵³
- Independent review: As a condition of approval, a code must be independently reviewed at intervals of no more than three years⁵⁴

Other requirements include:

- Format and language: Codes should be in freestanding and written in plain language

⁴⁹ ASIC, *Regulatory Guide 183*, 2013, p 14

⁵⁰ ASIC, *Regulatory Guide 183*, 2013, p 15

⁵¹ ASIC, *Regulatory Guide 183*, 2013, p 16

⁵² ASIC, *Regulatory Guide 183*, 2013, p 17

⁵³ ASIC, *Regulatory Guide 183*, 2013, p 18

⁵⁴ ASIC, *Regulatory Guide 183*, 2013, p 19

- Statutory requirement: Codes must meet general statutory criteria for code approval
- Promotion of code: Codes must be adequately promoted

ASIC Regulatory Guide 183 was the result of broad consultation from Industry stakeholders and represents a positive step towards the development of effective and enforceable industry codes. ISA/AIST recommend that any review of the development and administration of codes should consider *ASIC Regulatory Guide 183* as the minimum standard.

2.2.3 Developing a principle-based statutory best interest duty

ISA/AIST have continually advocated for a higher-level, principles-based best interests duty to create a more effective and sustainable professional obligation for the provision of financial advice and to address the information asymmetry in the client-adviser relationship. Given that one of the core objectives of the FoFA reforms was to improve the quality of advice and raise the professionalism of financial planning, it is concerning that the FoFA Streamlining Regulations seriously dilute the best interests duty.

As is the case for other mature professions, financial advisers should be subjected to a principles-based requirement to act in their client's best interests, in the law. The current s961B(1) represents such a duty, without the heavily qualified safe harbor contained in s961B(2).

2.2.4 Banning all forms of conflicted remuneration

Since 1996, conflicted remuneration has contributed to around \$97 billion in foregone national savings due to advisers recommending poorly performing products.⁵⁵

Over the past decade, Australia has seen a series of financial advice scandals in which investors have suffered significant losses. At the centre of these scandals was conflicted remuneration, where commissions and other incentives encouraged planners to recommend certain products, coupled with the lack of a legal requirement for financial planners to act in their client's best interests.⁵⁶

At the heart of the issue is the institutional ownership of the bulk of financial dealerships. This has created an environment where financial planners are influenced by the commercial objective of selling and distributing products developed by affiliated companies.

We have continually advocated for the banning of all forms of conflicted remuneration.

ISA/AIST strongly agrees with the *Financial System Inquiry's Interim Report's* observation that 'the principle of consumers being able to access advice that helps them meet their financial needs is undermined by the existence of conflicted remuneration structures in financial advice⁵⁷'. The law should impose a broad ban on all forms of conflicted remuneration for financial advisers, including indefinite ongoing asset based fees. Such a prohibition is critical to financial planner professionalism.

2.2.5 Distinction between 'independent' and 'aligned advisers'

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

⁵⁵ Industry Super Australia analysis based upon APRA data

⁵⁶ Parliamentary Joint Committee on Corporations and Financial Services (2009) *Inquiry into financial products and services in Australia*, Nov 2009

⁵⁷ *Interim Report Financial System Inquiry*, March 2014, 3-65

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 business 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.⁵⁸

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 are often vague.

We believe that there is merit in clearer labelling of financial planning independence. Clearly, while consumers might choose to seek out advice from a large well-resourced institution, it is not ideal that there is such consumer misunderstanding of the impact of related party associations and of adviser independence.

However, we strongly submit that such disclosure or indeed, any disclosure based proposals, are unlikely to materially improve consumer conceptions of planner independence in the short term. For that reason, we would have reservations about creating different regulatory settings for ‘independent’ and ‘aligned’ financial advisers or placing any reliance on labelling of independence or alignment to protect consumers from conflicted financial advice.

2.2.6 Adopting a fee for service advice model

There is much merit in the concept of financial advisers working to the same fee-for-service business model as other professionals, such as doctors. This model offers consumers a set time with the adviser, a fixed fee per visit, the ability to make appointments as required, and the prospect of developing a relationship where the adviser forms a comprehensive understanding of their financial history and objectives. Paying fixed fees for advice will help to eliminate adviser reliance on incentives or commissions and provides the consumer with greater transparency in relation to fees and the value of the advice. Importantly, it will actively encourage Australians to engage with their finances in the same way they do with their health.

2.2.7 Enshrinement of ‘Financial Adviser’ in law

ISA/AIST supports 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:

- Meet minimum education requirements
- Be recorded on the national register of financial advisers
- Over time, be subject to an approved professional standards/code of conduct
- Meet annual CPD requirements

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.

⁵⁸ Roy Morgan, ‘Confusion with Financial Planner independence continues’, August 2014
<http://www.roymorgan.com/findings/5716-confusion-with-financial-planner-independence-201408040221>

3. Options for the oversight of improved standards

ISA/AIST propose two options for the regulatory oversight of the improved standards (Option A and Option B outlined below).

In order to effectively deliver the professional, ethics and education standards outlined in this submission, a strong regulatory framework is essential. Key attributes for the oversight of improved standards should include independence, transparency, visibility and accountability.

An effective model for the delivery of these standards will not solve the significant failings of the current regulatory framework, but will provide an opportunity for uniform and improved standards for financial advice. We reiterate our very strong view that professional standards must build upon legislative requirements.

3.1 Option A: Development of a tripartite standards body

Despite the important work undertaken by some sectors of the finance profession with regards to promoting higher education and professional standards for financial advisers, our first preference is for standard setting to be approved or set by an independent body with statutory responsibility, separate from industry associations, as is the case for other professions.

The AFSL Working Group is currently developing recommendations regarding education and professional standards for advisers. However, in terms of establishing a body to oversee the setting of minimum training, education and professional standards for financial advisers on a more permanent basis, our preference is for the establishment of a tripartite standards body with a charter that is consistent with the objectives of RG183.

Key responsibilities of the body should include:

- Setting the minimum education and training standards for financial advisers
- Setting a uniform code of conduct for all advisers
- Overseeing the National Register for financial advisers
- Setting requirements for professional development

It would be appropriate for ASIC to play a key role in the oversight and development of this body, which should comprise consumer and industry representatives and have an independent chair (and possibly some independent members). While we acknowledge the not insignificant costs associated with this option, if correctly implemented it has the potential to deliver significant benefits for both advisers and consumers.

3.2 Option B: Co-regulation

Co-regulation of professional, ethical and education standards may be a feasible option given that some of the systems are already in place.

This model should include:

- ASIC Approval of codes of conduct consistent with RG183
- Introducing higher minimum educational qualifications and professional development enforced by ASIC
- Developing a National Register for financial advisers with oversight by ASIC

Co-regulation will require industry to play an active role in increasing standards. In particular, codes of conduct will need to be revised to a higher standard in order to obtain RG183 approval from ASIC.

3.3 Self-regulation

Some sectors of the financial advice industry have argued that self-regulation can achieve the proposals set out by this Inquiry.

ISA/AIST strongly caution against complete self-regulation due to the fragmented nature of the industry bodies, 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 proved 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 compulsory, long-term, and government-supported nature of superannuation savings gives rise to additional public policy concerns with permitting 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.⁵⁹

While industry associations may play a key role in promoting professionalism within the industry, a tripartite standards body should have the ultimate responsibility for setting truly independent standards.

⁵⁹ ASIC, *Regulation Impact Statement: Future of Financial Advice: Best interests duty and related obligations*, December 2012