



## CENTRE FOR LAW, MARKETS AND REGULATION

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Parliamentary Joint Committee on Corporations and Financial Services  
PO Box 6100  
Parliament House  
Canberra ACT 2600  
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**Additional information on ethical self-reporting as part of a question on notice set by the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry**

Professor O'Brien is Director of the Centre for Law Markets and Regulation (CLMR) within the Faculty of Law, UNSW Australia, and Dr. Gilligan is a Senior Research Fellow at the CLMR. Please find below additional information regarding ethical self-reporting requested by the Committee as a question on notice following Dr. Gilligan's personal appearance before the Committee at its Public Hearing in Melbourne on Monday 13 October 2014.

We hope that this additional information is of use to the Committee as it continues its Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry. If you require further information please do not hesitate to contact us.

Yours sincerely

Professor Justin O'Brien and Dr. George Gilligan

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**Background**

1. Dr. George Gilligan appeared before the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry (the Committee) at its Public Hearing in Melbourne on Monday 13 October 2014. Following his evidence Dr. Gilligan received a question on notice from the Committee to provide further information to the Committee on the subject of ethical self-reporting.
2. In their Submission of 4 September 2014 to the Committee Professor O'Brien and Dr. Gilligan made 4 recommendations:

**Recommendation One: The PJC should make detailed recommendations to Government to ensure that Australia's financial licensing regime is more proactive, accountable and transparent. In particular:**

- (i) tighten the licensing requirements so that the licence under which an individual gives financial advice is tied to that individual and their performance history, rather than them being sheltered under the licence of a large institution;
- (ii) improve the mandatory education and training requirements for those who practice in the financial services sector; and
- (iii) raise substantially the transparency surrounding the activities of those who give financial advice.

**Recommendation Two: The framing of the PJC inquiry should take account of the FSI and other relevant parliamentary inquiries so that gaps are identified and narrowed and evidence-based policy calibration is privileged.**

**Recommendation Three: The framing of professional obligation must take into account empirical evidence of the failure of existing codes of conduct and the dangers associated with the licensing regime limited to entities rather than attaching to individual advisers.**

**Recommendation Four: The PJC should render explicit the normative foundations of regulatory intervention, wherever it is situated (i.e. within professional associations or through a regime licensed by the regulator).**

## Why adopt mandatory ethical reporting?

3. We believe that mandatory ethical self-reporting can **raise levels of both specific and general deterrence against wrongdoing** in the finance sector and as an issue it permeates all four of our recommendations. As we stated in our submission: ‘...continuing ethical self-reporting should be a mandatory feature of a future licence retention system...’(para 12, p.7);  
‘Mandatory ethical self-reporting is an important element of our proposals as it **sheets individual accountability** within what to date has been an ambiguous system that to an extent has nurtured ambivalence about ethical and other behavioural standards, not only amongst individuals and organisations generating profits from the provision of financial services and products, but also amongst many of the investing community and some of those with regulatory responsibilities in the area.’(para 13, p.8);  
‘Such a reform is necessary to **counter the lack of transparency and evidential detail** that has had the effect of many so-called *bad apples* of the financial advice industry been camouflaged and at times sheltered within their organisational structures. On occasion, as infamously shown in the Commonwealth Financial Planning Limited (CFPL) scandal, this can be in spite of whistleblowers and victims seeking to highlight harmful behaviours that may be systematic and pervasive. These structural processes of organisational ambivalence, denial and sometimes cover-up are structural problems not limited solely to financial services and can apply in other sectors as well. Nevertheless problems with generating evidence that can reveal, and/or prove, harmful behavior in the provision of financial advice have been significant causal factors in the generation of relative ambivalence not only within the industry, but also within the wider community.’(para 14, p.8);  
Ongoing mandatory ethical self-reporting would make a **substantial contribution to the evidential database** thereby facilitating corporate and regulatory oversight.’(para 15, p.8); and  
Mandatory ethical self-reporting can **support the individual in their efforts to be compliant**, especially in those contexts where organisational priorities may stimulate them to be ethically flexible, morally numb or downright non-compliant. Similarly, the increased evidentiary detail and subsequent transparency and accountability, can **act as powerful stimuli for organisations** involved in the provision of financial services and products to construct not only appropriate product lines, sales and marketing processes, but also incentive regimes that are less short-term and align finance sector priorities more closely with civic society goals.’(para 17, p.9).
4. **We believe that mandatory ethical self-reporting can facilitate:**
  - **increased transparency;**
  - **increased accountability both individual and organizational); leading to**
  - **increased deterrence (both specific and general); and therefore contribute to**
  - **stimulating organisations to adapt their internal processes so as to be more cognisant of their obligations to customers, staff and civic society.**

## Overseas evidence regarding mandatory ethical reporting

5. One overseas example is in England and Wales, where all law firms (including sole practitioners), must have nominated to the Solicitor's Regulation Authority (SRA), an individual who performs the role of designated **Compliance Officer for Legal Practice (COLP)** and an individual who is the nominated **Compliance Officer for Financial Administration (COFA)**. The COLP and COFA should be champions of risk management and compliance within a firm, and will have responsibility for the firm's systems and controls. The type of systems needed are not prescribed as these will very much depend on what is appropriate for the type and size of the firm, its areas of risk, and the type of work and client base.<sup>1</sup>
6. The COLP must record any failure to comply with authorisation or statutory obligations, (including ethical obligations), and make such records available to the SRA and report any material failure (either taken on its own or as part of a pattern of failures) to the SRA as soon as reasonably practical. The requirement to provide an information report on an annual or other basis is set out in [Rule 8.7 of the Authorisation Rules](#) (for firms) and [Rule 4.13 of the SRA Practising Regulations](#) (for Recognised Sole Practitioners) and is at present linked to the renewals by firms of the practising certificates or registrations for relevant individuals in their practices. Firms and relevant individuals must also update the SRA by giving details of general changes that occur in respect of the firm.<sup>2</sup>
7. **It is this linkage back to renewals of practicing certificates and registrations which is so important. The continued licensing and therefore commercial survival of a firm is dependent upon a firm meeting its ethical and other obligations, especially in a systemic context.** Such systemic failures have of course been at the heart of the most egregious financial advice scandals in Australia such as CFPL and Financial Wisdom. The COLP model of mandatory ethical reporting to the SRA has potential in an Australian context.
8. This ties back to the evidence Dr. Gilligan gave at the Committee Public Hearing on Melbourne on 13 October 2014: 'Professor O'Brien and I...feel that there is a certain imbalance between the privileged position that participation in the financial sector allows through the mechanism of the **licence**—which is a **gift of the state**—and what might be termed the **civic duties and obligations that potential carries with it**. We think the balance has shifted too far towards an almost automatic expectation of assuming a licence. This has been compounded because of the organisational context—many of the financial planners and advisers in Australia are employed by large organisations, so there is a diminution of accountability and transparency in relation to the

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<sup>1</sup> Solicitor's Regulation Authority, *What is a COLP and COFA*, <http://www.sra.org.uk/solicitors/colp-cofa/ethos-roles.page>

<sup>2</sup> Solicitor's Regulation Authority, *Responsibilities of COLPs and COFAs*, <http://www.sra.org.uk/solicitors/colp-cofa/responsibilities-record-report.page>

activities of individuals who are selling products or recommending products to consumers. It also becomes less clear where the accountability mechanisms lie within the organisations.<sup>3</sup>

9. **A variation of the COLP model potentially could be adapted to the Australian financial advice context to meet the accountability deficit problem** highlighted by Dr. Gilligan in his evidence of 13 October 2014: **‘Accountability needs to be sheeted through the organisation, and high up the organisation.** I use the **analogy of audit:** why shouldn't there be a similar regulatory infrastructure within financial institutions in terms of financial advice as there is with audit? Audit is supposedly a fair and true reflection of the financial health or otherwise of any company. **Why shouldn't the financial advice that is handled by an individual—**whether it is Commonwealth Financial Planning, AMP or anybody—**be a fair and true reflection of the financial health of that advice?** Again it comes back to my point that it is probably going to have to be externally imposed—by the state, by the government—because I cannot see financial institutions doing this, because inevitably it will have some impact on them. Although I do not think it will be that great a negative, to be quite frank, in terms of bottom-line profitability’.<sup>4</sup>
10. **The COLP model could be a step towards addressing this accountability deficit** and the reform effect could be magnified if **melded with elements of the audit regulatory model.** That approach locates responsibility for audit high in an organisation’s infrastructure at board level and this means that the most powerful within an organisation have a focus and mandated obligation for truth in audit. **Similarly why should there not be mandated obligation on boards and senior management of financial organisations in Australia to have truth in financial advice?**
11. **The lever of the licence as a gift of the state could be the regulatory key to unlock the door to delivering truth in financial advice in Australia.** Again Dr. Gilligan’s evidence: ‘If major organisations are deflecting or choosing to adopt a *Nelsonian knowledge position* towards the behaviour of some of the individuals in subsidiaries that they operate, then that surely is an indication that that fulcrum needs to be pulled back further to the centre to achieve greater balance and have organisations still generating profit for their stakeholders.’<sup>5</sup>

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<sup>3</sup> J. O’Brien and G. Gilligan, *Appearance before the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry*, (2014), 45, [http://www.aph.gov.au/Parliamentary\\_Business/Committees/Joint/Corporations\\_and\\_Financial\\_Services/Financial\\_Adviser\\_Qualifications/Public\\_Hearings](http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Financial_Adviser_Qualifications/Public_Hearings)

<sup>4</sup> J. O’Brien and G. Gilligan, *Appearance before the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry*, (2014), 49, [http://www.aph.gov.au/Parliamentary\\_Business/Committees/Joint/Corporations\\_and\\_Financial\\_Services/Financial\\_Adviser\\_Qualifications/Public\\_Hearings](http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Financial_Adviser_Qualifications/Public_Hearings)

<sup>5</sup> J. O’Brien and G. Gilligan, *Appearance before the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry*, (2014), 50, [http://www.aph.gov.au/Parliamentary\\_Business/Committees/Joint/Corporations\\_and\\_Financial\\_Services/Financial\\_Adviser\\_Qualifications/Public\\_Hearings](http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Financial_Adviser_Qualifications/Public_Hearings)