



5 September 2014

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
CANBERRA ACT 2600

By email: corporations.joint@aph.gov.au

Dear Committee Secretary

Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry (the Inquiry)

The Australian Financial Markets Association (AFMA) appreciates the opportunity to make a submission to the PJC in relation to the Inquiry.

About AFMA

The Australian Financial Markets Association (AFMA) is the leading industry association promoting efficiency, integrity and professionalism in Australia's financial markets and provides leadership in advancing the interests of all market participants. These markets are an integral feature of the economy and perform the vital function of facilitating the efficient use of capital and management of risk. Market participants perform a range of important roles within these markets, including financial intermediation and market making.

AFMA represents over 130 members, including Australian and international banks, leading brokers, securities companies, state government treasury corporations, fund managers, traders in electricity and other specialised markets and industry service providers.

To advance the interests of our members, AFMA's mission is to:

- Lead and sustain effective regulation of the over-the-counter financial markets;

- Represent market participants in exchange-traded markets to ensure market processes and their regulation are effective and efficient;
- Encourage high standards of professional conduct in financial markets;
- Deliver professional development and accreditation programs to improve individual expertise;
- Develop new markets for financial products and encourage existing markets to reach their full potential;
- Promote Australia as a significant global centre for financial services, including operations service centres;
- Promote government policies and business conditions that support a strong financial sector; and
- Maximise opportunities for members to grow their business and contribute to the economic well-being of Australia.

Raising professional, ethical and education standards and competency

KEY POINTS

- The effective operation of the financial system is dependent on the competence of participants and trust in their capacity to provide their services in a secure and fair way.
- AFMA supports the development of a broad framework for promotion of industry standards of competence and professionalism in the provision of retail financial services that benefits licensees and their representatives, as well as consumers.
- The delineation between retail and wholesale clients remain as a cornerstone of financial regulation.

Overview

AFMA strongly supports the introduction of a clearly articulated, compulsory framework to raise professional standards and competency in the financial services industry. Financial advisers should be raised to the standard of a “trusted adviser”. There is some way to go in the industry to achieve this outcome.

The industry has been engaging with the Australian Securities and Investments Commission (ASIC) for some time about concerns with the existing training standards framework (referred to as the “RG 146” framework). The current approach to education standards in some areas is low quality and far too general. We therefore welcome the intensified focus on this area through this Inquiry, the Financial System Inquiry, and the Industry Working Group on Professional Standards of Financial Advisers (convened by the Assistant Treasurer and chaired by Treasury). AFMA is a member of the Industry Working Group.

The effective operation of the financial system is dependent on the competence of its participants and trust in their capacity to provide their services in a secure and fair way. Whether it is an institutional dealer assessing the operational risk of doing business with a trader in another institution or a retail client seeking to rely on advice being given to

them by a financial planner about the allocation of superannuation investments, the business will only take place if they have confidence in the competence and trustworthiness of their counterpart. Thus, a professional approach by persons involved in the industry is necessary for the full range of financial activity to take place efficiently (or at all in some cases) and, thus, is central to the success of the financial system in serving the needs of the real economy.

Background

Since the full implementation of the Financial Services Reform Act in 2002, many licensees have relied on ASIC's Regulatory Guide 146 Training Register, to assist them in determining which training and educational programs might be suitable for their representatives to undertake so that the statutory obligations noted above are met.

ASIC was initially reluctant to implement the Training Register, and since that time the Register has not been without issues. This is acknowledged within the industry. For example, there has been considerable concern about courses that purport to qualify a person to be a financial adviser within a very short time period. There are also concerns about the quality of some courses, and whether they actually help candidates develop skills and competencies *which are properly assessed*, rather than just imparting information.

In April 2011, ASIC released Consultation Paper 153¹ about its review of Regulatory Guide 146 and the training standards. It was in this consultation paper that ASIC introduced the concept of a national examination for advisers.

AFMA's response to the consultation paper was generally supportive of the need to raise standards of professionalism and training in the industry. However, a number of concerns were raised, based in part on AFMA's experience as a Registered Training Organisation (RTO), about assessment of competency and whether it can be properly assessed by a national exam.

The central question underpinning Consultation Paper 153 was how professional competence can be identified and assessed. This question is critically important to all authorities responsible for licensing professionals, most particularly in medicine and the finance industry.

The question itself cannot be answered without addressing the more fundamental question of what is competence. In the Australian vocational education framework competence is used as a catch-all concept to cover all of the skills, knowledge and attitudes needed to perform a particular job role or function. In competency-based education, competence is assessed by judging how well an individual has applied knowledge and skills in a workplace setting.

Competent individuals can generally:

- Apply knowledge, skills and attitudes in a range of familiar situations;

¹ ASIC Consultation Paper 153 Licensing: Assessment and professional development framework for financial advisers

- Deal with the responsibilities and expectations of the workplace;
- Use problem solving skills to handle unforeseen and ambiguous situations; and
- Transfer their skills and knowledge to new situations.

Considerable research has been conducted into professional competence and expertise; the research literature on competence consistently finds that the distinguishing feature of competent professionals is not how much they know but their ability to use their knowledge. Donald Schon - perhaps the most important writer in the field of professional learning - considers professional competence is more than factual knowledge and the ability to solve problems with clear-cut solutions; it is also the ability to manage ambiguous problems and to make decisions with limited information.

Knowledge, although an important component of competence, does not in itself constitute competence. Interestingly, some theorists argue that some kinds of knowledge are more important than others for competence. For example, Michael Polanyi argues that competence is defined by tacit rather than explicit knowledge (that which we know but do not normally explain easily) like the use of rules of thumb and intuition.

A national exam can be a reliable and valid method of assessing explicit knowledge and some cognitive processes such as application and interpretation, both clearly important components of professional competence. However, knowledge and abstract problem-solving skills do not in themselves constitute competence. For example, while an adviser may know what a share is and how to calculate a dividend stream, it does not mean that they can competently devise investment strategies that are both compliant with their firm's operational guidelines and meet the needs, objectives and risk profile of a client. Competence of this nature cannot be assessed in an exam. The most valid methodology for evaluating an individual's competence is to assess how they perform in the workplace. This is because competence is context-dependent and involves applying knowledge, skills and attitudes in an authentic professional situation.

There was a great deal of feedback to ASIC from across the industry about the proposals in the consultation paper. Consequently, the proposed start date of July 2012 for the national examination framework did not proceed.

In September 2012, ASIC turned off the Training Register – that is, the register was frozen at that point in time and no further courses or programs were able to be submitted to ASIC for inclusion from that time onwards.

ASIC subsequently released Consultation Paper 212² in June 2013, which proposed a multi-regime approach to minimum training standards. In brief:

- Regime A applied to existing advisers who did not want to change their advice activities;
- Regime B applied to existing advisers who did decide to change their advice activities between 1 July 2015 and 31 December 2018; and
- Regime C applied to new advisers after 1 January 2019, or advisers who change their advice activities after that date.

² ASIC Consultation Paper 212 Licensing: Training of financial product advisers – Update to RG 146

In conjunction with a number of peak industry bodies, AFMA raised fundamental issues with ASIC about the proposals in Consultation Paper 212. The primary concern raised by the industry bodies was that the ASIC proposals did not provide for a holistic approach to lifting standards of professionalism and competency – rather, the proposals only addressed the kinds of qualifications that an adviser should hold.

Promoting industry standards and professionalism

AFMA welcomes the intensified focus on this area through this Inquiry, the Financial System Inquiry, and the Industry Working Group on Professional Standards of Financial Advisers.

AFMA supports the consideration of a broad framework that benefits licensees and their representatives, as well as consumers.

The Corporations Act obligations on financial services licensees to ensure that representatives are competent to provide those services are not the same as analogous professions (eg. accountants, lawyers and medical practitioners) who must obtain and maintain an externally mandated qualification and must undertake minimum levels of continuing professional development in order to continue to work in their profession.

The introduction of similar requirements in the retail financial advice industry will likely only be achieved through a longer term approach and generational change, but is necessary in order to improve the professionalism of the industry and promote investor confidence.

AFMA does not support consideration of the introduction of the possible components of a framework (for example, the national examination proposed by ASIC) in isolation from all the other components that are necessary to implement an effective professional standards and competency framework.

New education, qualifications, training and competency standards should be considered in a holistic way. Any new framework that is introduced should also ensure that the regimes administered by ASIC and by the Tax Practitioners Board (relating to financial advisers who also provide a tax (financial) advice service) are co-ordinated.

AFMA supports the adoption of a model akin to those that are in place for other professions in Australia. Components of this type of framework would likely include:

- Minimum educational qualifications in order to gain entry to the profession, or alternatively, a minimum number of years of experience to accommodate more mature financial advisers who may not hold tertiary qualifications. Over time however, it is highly likely all advisers will hold tertiary qualifications as a pre-requisite to employment in the financial services industry;
- The successful completion of an assessment that would be applicable across the industry regardless of the nature of the adviser or their employer, or the kind of advice business the employer/licensee operates. The assessment might include a core component plus additional modules that relate to the adviser's areas of specialisation;

- Additional assessments that must be successfully completed in order to become a more senior adviser, or advise on more specialist, niche or complex products (akin to a specialist medical practitioner, or an accredited specialist or a senior counsel in the legal practitioner context);
- Ongoing professional development and continuing education for the whole of the adviser's career in order to maintain the "accreditation" they have achieved;
- An independent review mechanism to assess the competency of advisers;
- A strong focus on ethical behaviour and conduct, both at the adviser and the licensee level; and
- Effective and stringent monitoring and review of the framework to ensure it continues to deliver good outcomes for advisers and consumers.

Delivery of the components of the framework should be flexible so that education, assessment and ongoing professional development can be made available by a range of providers, so long as those offerings meet the standards set for the framework. For example, structured and professional internal programs (ie. run within licensees) could be a substitute for industry programs provided they meet the required standards.

It is important that the framework applies across the whole industry to ensure the universal lifting of standards. As a general proposition, AFMA does not support the exclusion of certain types of advisers from the framework on the basis they only advise on one product class.

AFMA is also of the view that advisers who give personal advice to non-retail customers who are not corporates or institutions (that is - holders of AFSs, listed companies, Government bodies and the like) should also be subject to the professional framework. The "wealth" (net assets, income and so on) of an investor is not always a good proxy for the level of sophistication of that investor, or their ability to understand information in relation to financial decision making. Advisers who advise these types of non-retail customers should be expected to be equally as competent and qualified as advisers who advise retail customers. In that sense, the professional framework should be designed with the needs of the customer in the forefront.

Register of financial advisers

The Inquiry is no doubt aware that the Government has convened an industry working group, in which AFMA is a participant, to make recommendations on the implementation of a register of financial advisers. The working group reported to the Government on 22 August 2014, and we understand a further announcement by the Government is imminent.

Wholesale markets

The level of professionalism in the wholesale financial markets reflects the competence and trust of the individuals involved. In this respect, it is similar to retail financial services, however, the relationship between two institutional traders dealing with each other is very different to that which exists between a retail client and their financial adviser. The imbalance in knowledge and sophistication between two traders is much less, if any, and

there is greater reliance on the counterparty trading in a manner that is in keeping with good market practice (as well as the law). Moreover, given the scale and dispersion of trading in many institutional markets, dealers have a significant responsibility to support the efficiency and the integrity of the market place.

Similarly, the law recognises that institutional and wholesale clients who interact with their advisers do not require the same level of protection afforded to retail customers, as institutional clients are generally highly sophisticated and have a range of resources at their disposal to assist in making strategic and investment decisions.

The current regulatory framework recognises that wholesale markets do not require the same level of government intervention as retail markets. Of course, the law does provide protection against harmful practices like insider trading, market manipulation and misleading and deceptive conduct and this is absolutely essential to the effective operation of the wholesale market. However, within this framework, the wholesale markets are much more amenable to industry of its own volition adopting practices and promoting conduct that will support the efficiency and integrity of trading on the wholesale markets. For example, through AFMA the institutional OTC markets have developed infrastructure in the form of standard documentation (including credit support annexes) and trading conventions that enable the efficient and safe operation of the markets.

In relation to standards in the wholesale and institutional sectors, there is significant government and public focus on shortcomings that have come to light in relation to standards of conduct in the global markets. Against this backdrop, it is appropriate for the Australian industry to ensure that its industry standards for conduct and competency of traders in the local market are well-designed and support continued confidence in the markets. Traditionally, the industry has liaised and worked closely with the financial regulators in the development, maintenance and management of these industry conventions. Given the issues encountered in the global markets and the exceptional pace of change in the OTC industry consequent to regulatory reform, it is essential to build on these relationships going forward and to actively promote the widespread adoption of good industry practice.

Programs for professionalism in the wholesale markets

AFMA is a Registered Training Organisation and provides a range of education and training services to promote professionalism in the financial markets. Our programs include, amongst other things:

- Financial Markets Accreditation for front office staff, who advise and/or deal in the financial markets;
- Operations Accreditation for back-office staff, who manage trade verifications, confirmations, settlements and reconciliations.

AFMA also offers a range of continuing education programs covering diverse topics such as financial products and their mathematics, regulation and compliance and risk

management – see <http://www.afma.com.au/learning/ce/workshops.html>. These programs promote professionalism in the markets.

AFMA regularly updates its programs to reflect changes in the industry and new developments. These programs are examples of areas where industry can put in place expectations about standards of behaviour and the minimum competencies that are required for the performance of roles in the wholesale markets.

This approach is consistent with the distinction in the Corporations Act between the needs of retail and wholesale clients and the level of protection that is afforded to them. Accordingly, the delineation between retail and wholesale clients should be preserved as a cornerstone of financial regulation and, in this context, government should work with the financial services sector to support an industry-based approach to professionalism in the wholesale market.

If you have any questions about this submission, please contact me on [REDACTED]
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Yours sincerely

Tracey Lyons
Head of Policy