



AUSTRALIAN BANKERS'
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Ms Toni Matulik
Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
CANBERRA ACT 2600
corporations.joint@aph.gov.au

Dear Ms Matulik,

Professional standards

The Australian Bankers' Association (ABA) appreciates the opportunity to provide further comments to 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.

1. Questions on notice

Below are the responses to the questions taken on notice 14 October 2014.

1.1. Regulations requiring disclosure of institutional ownership

1.1.1 What were the requirements for disclosure of institutional ownership prior to 2004?

The pre Financial Services Reform (FSR) disclosure requirements varied across products and between different types of licensed providers. Pre FSR, Securities Dealers were required to provide an Advisory Services Guide (ASG) to retail investors. The ASG should contain the following information:

- (i) name of the licensee and their ACN number (if the licensee is a corporation);
- (ii) registered address of the licensee; and
- (iii) **if the licensee is a member of a financial group, the name of the group** (and also any group affiliations that may have any effect on the advice).¹

1.1.2 What are the current requirements?

Financial Services Guide

It is a legal requirement for both an Australian Financial Services Licensee (AFS Licensee) and an Authorised Representative of an AFS Licensee to provide a Financial Services Guide (FSG) to a person

¹ PS121.34, ASIC Policy Statement 121 Investment advisory services: retail investor protection requirements.

if they provide a financial service to the person as a retail client². This includes clients receiving general advice or personal advice about Tier 2 products (subject to certain exemptions).

The FSG of an AFS Licensee must disclose **information about any associations or relationships between the AFS Licensee, or any related body corporate, and the issuers of any financial products**, being associations or relationships that might reasonably be expected to be capable of influencing the AFS Licensee in providing any of the authorised services³.

The FSG of an Authorised Representative must disclose **information about any associations or relationships between the Authorised Representative, or any employer of the Authorised Representative, and the issuers of any financial products; or the authorising AFS Licensee, or any of the authorising AFS Licensees, or any related body corporate of the authorising AFS Licensee or any of the authorising AFS Licensees, and the issuers of any financial products**; being associations or relationships that might reasonably be expected to be capable of influencing the Authorised Representative in providing any of the authorised services⁴.

Statement of Advice

The Statement of Advice (SOA) of an AFS Licensee must disclose information about any remuneration (including commissions) or other benefits that any of the following is to receive, that might reasonably be expected to be or have been capable of influencing the AFS Licensee in providing the advice:

- (i) the AFS Licensee;
- (ii) **a related body corporate of the AFS Licensee;**
- (iii) a director or employee of the AFS Licensee or a related body corporate;
- (iv) an associate of any of the above; and
- (v) any other person in relation to whom the regulations require the information to be provided.⁵

The SOA of an Authorised Representative must include a statement setting out the name and contact details of the authorising AFS licensee, or of each of the authorising AFS licensees; and stating that the Authorised Representative is the Authorised Representative of that AFS Licensee or those AFS Licensees⁶.

The SOA must also include information about the remuneration (including commissions) or other benefits that any of the following is to receive that might reasonably be expected to be or have been capable of influencing the providing entity in providing the advice:

- (i) the Authorised Representative;
- (ii) an employer of the Authorised Representative;
- (iii) **the authorising licensee, or any of the authorising licensees;**
- (iv) **an employee or director of the authorising licensee, or of any of the authorising licensees;**
- (v) **an associate of any of the above;**

² ss941A, 941B *Corporations Act 2001* (Cth).

³ s942B(2)(f), *Corporations Act 2001* (Cth).

⁴ s942C(g), *Corporations Act 2001* (Cth).

⁵ s947B(d), *Corporations Act 2001* (Cth).

⁶ s947C(d), *Corporations Act 2001* (Cth).

- (vi) any other person in relation to whom the regulations require the information to be provided.⁷

1.2. ABA involvement in Treasury working group

In January 2014, the Assistant Treasurer announced a review of professional standards applied to financial advisers. Subsequently, Treasury has established the Industry Working Group to consult with industry and other stakeholders.

The ABA notes that the Treasury will be providing the Committee with information regarding the Industry Working Group.

1.3. Activity based incentives

1.3.1 Referrals from bankers to financial advisers

Some banks will provide incentives for customer facing staff who do not provide personal advice on Tier 1 products ('bankers'), to refer customers to in-branch employed financial advisers or other aligned financial advisers. These incentives may be in the form of a contribution to their performance based on a balanced scorecard, a contribution to the banker's remuneration or non-monetary benefits (eg a team lunch).

It is important to note that referral benefits have not been regulated through the FOFA reforms. These benefits are not paid in respect of the giving of advice or a product recommendation and are not paid to the advice provider. These benefits do not have the capacity to conflict financial advice given by the person receiving the referral.

There are a number of reasons why banks should encourage employees to make referrals:

- **Manage risk for customers:** Referrals are important to ensure that customers get the right information about other financial services and products that will protect them or help them reach their financial goals. For example, it is important that customers receive appropriate information about personal risk insurance if they have just taken out a mortgage.
- **Manage legal requirements:** Referrals ensure that customers have access to suitably trained and knowledgeable financial advisers who have the relevant training and product authorisations. This ensures compliance systems are managed and bankers do not attempt to service customers beyond their legal and training qualifications.
- **Meet customer needs:** Referral incentives motivate bankers to refer customers to those parts of the bank which can best meet their needs and avoids poor customer outcomes. That is, customers who are in-branch are already focused on their financial affairs and are open to a "teachable moment" (theory which underpins financial literacy learning).
- **Accessibility of advice:** Broadly speaking, between 1 in 4 to 1 in 5 Australians obtains relevant financial advice. Referring a customer in branch, while the customer is focused on their financial arrangements increases the likelihood that the customer will obtain relevant financial advice.

⁷ s947C(e), *Corporations Act 2001* (Cth).

Productivity incentives

Some banks provide incentives to financial advisers based on the number of new customers they retain or the number of advice documents they prepare. ASIC has indicated that the number of new clients is a non-volume-based criterion for balanced scorecards⁸. A performance benefit based only on non-volume-based criteria is not presumed to be conflicted remuneration⁹.

Despite ASIC guidance that productivity incentives are not presumed to be conflicted remuneration, these incentives have been criticised as being a quasi-measure for product sales. However, these productivity incentives take away the incentive to always make a product recommendation and will ensure the financial adviser is remunerated for strategic advice, advice to pay down debt, or other advice that does not involve a product recommendation, such as aged care advice, estate planning, etc.

Productivity incentives are also an important part of enabling employees to demonstrate their performance and contribution to servicing customers.

1.4. In house product recommendations

There are a range of legal requirements and industry practices to ensure that a recommendation that a customer acquire a product issued by the employer or related party of the financial adviser (in house product) can be made in the best interests of the customer.

Broadly speaking, banks dedicate tremendous resources and expertise to develop robust compliance arrangements for the provision of financial advice. These arrangements cater to a broad range of regulatory requirements (including financial services, lending, AML/CTF and privacy) across thousands of employees and hundreds of locations.

The table below sets out the existing legal requirements and industry practices that contribute to managing conflicts and ensuring appropriate personal advice recommendations regarding in-house Tier 1 products.

Personal advice on Tier 1 products		
Legal / Regulatory requirement	Implementation arrangements	Reference
Ensure that representatives are adequately trained, and are competent to provide the financial services.	<p>Banks run extensive programs to ensure the appropriate competency of their financial advisers. These programs include:</p> <ul style="list-style-type: none"> • Education and qualification requirements. • Professional designations (eg CFP). • Technical training on the features of financial products and services. • Technical training on tax, Centrelink and aged care rules. • Technical and compliance training on meeting best interests requirements, ensuring advice is appropriate and prioritising the interests of the client. • Compliance and risk management training on conflicts of interest, Corporations Act requirements and identifying and escalating compliance breaches. <p>Importantly, these competency programs go beyond the elements required to deliver technically sound financial advice and include operational risk management and compliance issues, as well as organisation values and culture training - undertaken by all bank employees.</p>	s912A(f)

⁸ RG 246.136, ASIC Regulatory Guide 246: Conflicted Remuneration.

⁹ RG 246.137, ASIC Regulatory Guide 246: Conflicted Remuneration.

Adhere to full best interests duty obligation and associated provisions	Banks have implemented robust processes to establish and document the customer's objectives, financial situation and needs. These include detailed 'fact finds' and client questionnaires; guided customer conversation models; appropriate file and record keeping arrangements.	Pt7.7A Div 2
	In circumstances where it is appropriate to replace one product with another, financial advisers must complete appropriately detailed product comparison and switching analysis.	
	Banks maintain research teams to investigate financial products and maintain Approved Product Lists (APLs) to ensure products have been adequately researched and the product features and risks are understood by financial advisers. APLs include financial products required to meet the needs of the target client segment of the bank, including external financial products. An APL is used to manage legal and compliance risks for the AFS Licensee and the financial adviser. APLs also ensure that the financial adviser is able to provide good advice on that range of products, which means better customer outcomes.	
	"Off APL" approval processes allow financial advisers to advise on financial products that are not on the APL, where it is appropriate to do so. For example, where a client has expressly asked for a product to be considered, the product is an existing product, or there are other classes of products not available on the APL that would better meet the client's needs.	
	AFS Licensee policies provide guidance that the financial adviser must decline to make a product recommendation if there is not a product that genuinely meets the objectives, financial situation and needs of the client.	

1.5. Education, competency and training

1.5.1 Overview of RG146 training arrangements

Complying RG146 training courses are delivered by private training providers and by banks that are complying Registered Training Organisations (RTOs). Bank in-house or tailored training solutions ensure the bank is confident in the training outcomes, is satisfied their financial advisers are competent, and can demonstrate compliance with RG146 and AFS Licensee obligations.

Generally speaking, training courses are modularised in respect of a class of product. For example, a training provider may deliver a life insurance course that will enable the financial adviser to obtain an authorisation to provide advice on life insurance, with further courses or modules required in respect of other classes of product. Multiple courses would be required to act as a financial adviser.

Many banks have already implemented internal policies that require the completion of ethics modules as part of Continuing Professional Development (CPD) requirements.

1.5.2 Cost of course delivery

Banks will utilise private complying Registered Training Organisations (RTOs) (either in house or outsourced) to deliver complying RG146 training to staff.

It is estimated that delivery of RG164 training modules can cost \$600 - \$1,000 per adviser for new competency skills. Diploma level qualifications can cost between \$2,000 - \$6,000 per adviser. Additional costs are incurred in relation to induction and ongoing professional development training to maintain RG146 compliance.

In addition to RG146, banks run professional development programs beyond licensing requirements to support the ongoing professional development of their financial advisers.

We note that on 29 October, the ABA was provided, in writing, with a series of additional questions on notice. We will provide our response to those questions, separately as requested.

2. Additional remarks

2.1. Independent Council

The ABA's proposal for the design of the professional standards framework contemplates a co-regulatory model and includes the creation of new architecture in the form of an independent council that would set minimum, standardised education, competency, and professional conduct and behaviour standards ("independent council"). Importantly, the independent council will be driven by the industry but build upon existing structures and systems.

The ABA believes there is a compelling case for the creation of this new architecture as opposed to leveraging existing regulatory or industry infrastructure. The case for the creation of an independent council includes the following, which cannot currently be achieved with the existing framework:

- The ultimate decision maker will be a Board and advisory committees, consisting of advice, education and ethics experts and other stakeholders (i.e. consumer representatives) (rather than regulator or Minister);
- Ability to develop broader professional conduct and behaviour standards in addition to education and competency standards – both functions cannot currently be undertaken by one part of the existing regulatory and industry infrastructure;
- Demonstrate the professionalism of the advice industry and move towards streamlined co-regulation, which allows the industry to adopt consistent high standards of education, competency, and professional conduct and behaviour applicable for the Corporations Act and the Tax Agent Services Act;
- Allow flexibility in design of education and competency standards for different advice specialties while ensuring the same quality and rigour of standards for all financial advisers providing personal advice on Tier 1 products;
- Review and approve education and training courses to contribute to true "qualifications portability". Maintain a publically available register of approved training courses; and
- Provide confidence for AFS licensees that all financial advisers providing personal advice on Tier 1 products can operate at a consistent standard of education and competency and professionalism, which will promote 'qualifications portability' and reduce costs associated with retraining and lengthy induction processes.

2.1.1 Enabling the independent council

Importantly, the standards developed by the independent council must be mandatory for all AFS licensees and be enforceable by ASIC. This will require some degree of law reform to achieve. Options to enable the operation of the independent council and the mandatory nature of standards include:

- Standards Australia model – An independent council charged by the Government to set standards for the financial advice industry. These standards are called up into the Corporations Act and are mandatory for all AFS licensees;
- AFS licence condition – A class order amending the AFS licence conditions to require compliance with the standards set by the independent council; and
- Statutory underpinning of the independent council – Legislation is developed to create the independent council and make standards mandatory for all AFS licensees;

2.1.2 Independent council composition

The board of the independent council should be comprised of experts acting in their individual capacity, rather than representatives of organisations. Membership should include experts in financial advice, education and training, and ethics. The board should also have consumer representation. We envisage the board comprising five individuals.

In developing the standards, the independent council should be advised by delegated advisory committees with appropriate industry, regulators, EDR schemes, education, training and ethics experts, and consumer representatives.

Yours sincerely,

Steven Münchenberg