

Consultation Paper 153 *Licensing: Assessment and professional development framework for financial advisers* April 2011

Submission

Background

1. The Stockbrokers Association of Australia is well placed to comment on CP153. Around 50 of our Principal Member firms and over 9000 of their representatives are subject to RG146 and will be affected by any new proposals.
2. The Association has since 2001 offered an education program which is a 'course in stockbroking' that has embedded within it the PS/RG146 requirements. This program is now known as *The Professional Stockbrokers Program* and candidates receive a Professional Diploma in Stockbroking upon successful completion. This is a unique qualification for our industry and one that more than exceeds the current RG146 requirements. The Program is offered through our partner, DeakinPrime, the corporate professional training division of Deakin University. In the 9 years since the course has been offered, some 9000 people have undertaken it.
3. We also note that some of the separate stream of work being conducted as part of the *Future of Financial Advice* reforms regarding **professional standards** will impact on competency. The Association commends the work of the Government in this area, and is pleased to be contributing to the process through the Minister's **Advisory Panel on Standards and Ethics for Financial Advisers**. If all advisers become subject to an enforceable code of ethics and code of conduct, this – together with the new statutory fiduciary duty to act in the client's best interest - will lead to an increase in standards of behavior and service to clients.
4. **In summary**, our Members are **not convinced** that the measures proposed by ASIC in CP153 will increase standards and competency of advisers across the industry.
5. In this submission, we will endeavour to address the particular questions asked by ASIC. However, we note that in some areas there is a lack of detail in the proposals which makes it difficult to make detailed responses.

The Review

6. ASIC commenced its review of training and competency requirements about the time of the *Storm Inquiry*¹. ASIC informed the Inquiry that it was
 - a) ...reviewing RG146, 'with a view to improving training standards and will put forward proposals for change in consultation with industry and stakeholders'²
7. The Parliamentary Joint Committee acknowledged that concerns had been raised during the *Storm Inquiry* as to training qualifications and competency standards³. However, there was no recommendation in the PJC's final report regarding these matters. Indeed it would have been very difficult for the PJC to make a recommendation on training and competency for the whole financial services industry, as it only examined in detail the actions of 2 out of some 5000 financial services licensees. Moreover, most of the advisers at *Storm Financial* were fully qualified financial advisers, holding the Diploma of Financial Planning, which suggests that training and competency standards were not the key factor at play. A key factor was the extent to which advisers acted ethically, which makes it **more a failure of professional standards than training and assessment**.
8. ASIC administers the [register](#) of approved courses under RG146. ASIC reviewed RG146 in 2007⁴, which led to changes to the registration requirements, and a 'clean-out' of defective or out-of-date courses on the register.
9. The review of RG146 which ASIC now uses as the rationale for the proposals in CP153 consisted of interviews with a small sample of licensees in 2009, and 15 industry bodies (including the Association) in 2010. Our feedback to ASIC in the (relatively short) interview was that:
 - RG146 was generally thought to be deficient and needed tightening-up, and
 - CPD requirements needed to be more detailed.
10. It is within ASIC's power to improve the requirements of RG146. It is therefore surprising to see that ASIC is now suggesting that, based on a relatively cursory piece of research, the whole RG146 framework ought to be rejected. We note that CP153 does not specifically state that RG146 is to be discontinued. However, it is difficult to see how the new proposals could exist in parallel with a continuing RG146.

¹ Parliamentary Joint Committee on Corporations and Financial Services (Cth) *Inquiry into financial products and services in Australia ('Storm Inquiry')*

² *Storm Inquiry Report* November 2009 paragraph 6.119

³ As set out in CP153 at page 7

⁴ ASIC *Consultation Paper 88: Training of financial advisers* July 2007

ASIC's Proposals

11. ASIC is proposing a regime with 3 features:
 - **Financial Services Competency Certificate (FSCC):** a compulsory uniform examination for all advisers, modeled on the US Series 7 exam.
 - **Supervision:** new advisers need to be supervised by a supervisor for 12 months.
 - **Knowledge Update Review (KUR):** a compulsory examination every 3 years to check that knowledge is up to date.
12. It is unclear how one uniform examination could cover the diverse range of products and services across the spectrum of the financial services industry.
13. It is also unclear how the new regime will handle specialist accreditation as per the current RG146 regime. For example, apart from qualifications in Securities and Managed Investments, our Members devote substantial resources, time and money to fulfilling the specialist accreditations for :
 - Derivatives Accreditation (ADA 1&2)
 - Superannuation
 - Margin Lending, and
 - Designated Trading Representatives⁵.
14. As well as the substantial costs to Members, the various industry bodies like the Stockbrokers Association have invested millions of dollars in the development and delivery of PS/RG146 compliant and other courses for the lifting of standards across the industry. Most of these costs are not able to be recouped, but are provided as a service to Members.
15. Our Members also question:
 - a) whether the desired outcome could be better achieved by improving and strengthening the current model of RG146 which (with its predecessor PS146) has been operating since 1999, rather than introducing a whole new regime for competency training and assessment
 - b) how the new proposals will fit with the existing RG146
 - c) why there is no grandfathering mechanism
 - d) whether continuing education requirements could be better achieved by improving and strengthening the Continuing Professional Development (CPD) requirements rather than introducing a new triennial Knowledge Update Review test
 - e) whether a centralized delivery model is the right one

⁵ The Association has entered into an agreement with ASX to deliver training and accreditation for DTR's previously delivered by ASX prior to the transfer in market supervision to ASIC on 1 August 2011 in order that Members can satisfy ASIC (ASX) Market Integrity Rules, particularly Rule 2.5.5(c) .

- f) whether the uniform examination will be appropriate for all advisers, and how specialist modules will be structured around the uniform examination, if that is to be the model
- g) how the proposals will affect the current arrangements for specialist examinations and accreditation of:
 - i. Responsible Executives (and Responsible Managers),
 - ii. Designated Trading Representatives, and
 - iii. Accredited Derivatives Advisers

Series 7

16. The United States Financial Industry Regulatory Authority's Series 7 *General Securities Representative Exam* is clearly the model for these reforms. The FINRA Series 7 is the base level requirement for all advisers and brokers in the US. It is accompanied by other specialist modules – e.g. Series 10 for managers and Series 16 for supervisory analysts – that must be completed depending on a person's duties and responsibilities. It is an impressive system. However, Series 7, although structurally and operationally very effective, has not prevented major financial disasters in the United States, particularly those during (or which led to) the GFC. Moreover, the United States does not have the equivalent of RG146 running in parallel. There would be obvious difficulties caused if the new regime were to run in conjunction with RG146. Accordingly, **we seek clarification as to ASIC's plans for RG146.**

Why not fix RG146?

- 17. From the discussion in CP153, the perceived problems with RG146 appear to be related to:
 - a) Low or inconsistent standards of training providers
 - b) Differing quality of courses on offer
 - c) Lack of guidance on Continuing Professional Development (CPD) and
 - d) Concerns over the capability of state training authorities to oversee skill levels and standards.
- 18. These problems could be addressed without the need to completely change the training regime. While a limited review of RG146 was undertaken by ASIC in 2009 and 2010, there is no reason why a more thorough review could not now be undertaken and the regime brought up to the correct standard.

Why No Grandfathering?

19. The current proposals contain no facility for the recognition of prior qualifications and experience. 'Recognition of Prior Learning' is a well known concept in tertiary-level and vocational education in Australia. It should apply for advisers who are recently qualified or who can demonstrate that they are otherwise appropriately qualified. On the introduction of the then PS146 in 1999, there was such a facility: former members of the Australian Stock Exchange were exempt from the original requirements, on the grounds that they had sufficient knowledge and experience. Without such a mechanism in the current proposals, senior and experienced advisers will inevitably choose to leave the industry rather than sit a new series of examinations. This will lead to a smaller pool from which accredited supervisors could be drawn, and could be detrimental to investor protection.

Continuing Professional Development

20. As discussed at CP153.51, Members agree that there is a lack of guidance or specific requirements regarding Continuing Professional Development (CPD). In Stockbroking, there is one specific requirement for CPD: the prescribed 8 hours compliance training for Responsible Executives⁶, which is consistent with the Stockbrokers Association's CPD requirement for members of 8 hours compliance and 12 hours other CPD, which is now the industry standard⁷. We note that there are no such requirements for Responsible Managers under AFSL requirements, which would appear anomalous.
21. Other regulated professions (for example accountants and lawyers) all have CPD requirements as a key part of their professional requirements. For those professions which are accredited under the various Professional Standards Schemes, CPD is usually part of the conditions upon which the protections afforded by the Scheme are granted, for example the limitation of liability. This is because CPD is recognised as a mechanism to improve standards of competency on an on-going basis.
22. Indeed, **a strong CPD regime may obviate** the need to conduct the proposed triennial **Knowledge Update Review**, since it will ensure that the adviser's knowledge is kept **up to date**.
23. We would therefore submit that **ASIC should mandate minimum annual CPD requirements for all advisers**. These could be modeled on existing Responsible Executive requirements. However, these requirements only relate to compliance training. CPD should also cover other areas of professional development, for example product knowledge and communications skills. This is why the Stockbrokers Association prescribes 12 hours in

⁶ ASIC Market Integrity (ASX Market) Rule 2.3.1; ASX Clear Rule 4.22.1

⁷ Stockbrokers Association of Australia *CPD Guidelines* (Members are required to undertake 20 hours CPD per annum, including 8 hours in Compliance-related matters)

addition to 8 hours compliance training. We would recommend this be taken into account in any new ASIC requirements, since compliance training, while important, is not the only skill necessary to achieve competence.

Costs

CP153 C1Q6: What costs would you expect to be involved in the setup and administration of a national exam? What costs would you expect to be incurred by industry (both advisers and licensees) in being required to sit such an exam?

24. At CP153.107, ASIC states:

In developing the proposals in this paper, we have carefully considered their regulatory and financial impact.

25. Since there will be a significant cost impact, Members would request **further details** to be provided of ASIC's assessment of the **financial impact** of the proposals on Licensees.

26. There will be a significant cost to members (and ASIC) in the implementation of the new scheme. The likelihood is that ASIC will recoup its costs from industry, so together with Members' own costs, the overall result will be that costs to clients will increase. More details of ASIC's and Brokers' projected costs are as follows:

a) **ASIC:** Significant costs and management time developing the examinations and engaging an external provider will arise; thereafter there will be continuing administration costs, including database management. This is on top of ongoing direct costs to the service provider. These costs will need to be recouped from industry unless the Government makes a special allocation (which it should consider).

b) Brokers:

i. **Preparation for FSCC exam:** the costs of external providers or in-house resources to run courses to prepare advisers to sit the exam. Cost in lost revenue while advisers prepare and sit the exam. (In US an industry has sprung-up providing preparation training for the Series 7 Exam. Typically, this training costs around \$US500 or more per person.) Ignoring the costs of lost revenue, management time and development for the moment, we conservatively estimate the direct costs to our industry of preparation for the FSCC at around **\$500** per person, including preparation training and administration. Since we estimate that there are over **9000** retail advisers and others who are RG146 qualified, this is an all-up cost to the industry of over **\$4,500,000**.

- ii. **FSCC exam:** registration fees for each adviser to sit the exam, which we estimate will be around \$300 per person. (The US Series 7 costs US\$265.) For the 9000 affected people, the cost to industry would **\$2,700,000**.

Therefore, direct costs to stockbrokers for the implementation of the FSCC would be somewhere in the region of **\$7,200,000**, or **\$144,000 per firm**. This does not include the cost of lost revenue, management time and administration, which could easily double this figure.

- iii. **Preparation for Knowledge Update Review:** Again, ignoring the costs of lost revenue, management time and development, we conservatively estimate the direct costs to our industry of preparation for the KUR at around **\$250** per person, or half of the cost of the FSCC, including preparation training and administration. For the 9000 affected people, this would be an all-up cost to the industry of around **\$2,250,000**
- iv. **KUR exam:** registration fees for each adviser to sit the exam, which we estimate will be around \$150 per person or half of the fee for FSCC. For the 9000 affected people, the cost to industry would **\$1,350,000**.

Therefore, direct costs to stockbrokers for the implementation of the KUR would be somewhere in the region of **\$3,600,000**, or **\$72,000 per firm**, plus the cost of lost revenue, management time and administration, which could easily double this figure.

This significant expense comes on top of other regulatory-based costs, including the significant costs of compliance with the **best execution rule**⁸, which includes IT, client relationship, training, and policy and procedural updates. Assuming that licensees will have to bear the significant costs of both the FSCC and the KUR, these costs will eventually lead to higher fees to clients.

Supervision/Mentoring Proposals

- 27. Supervision of advisers is already a key requirement of stockbroking firms. Our Members have established detailed management and supervisory structures in accordance with licensing and regulatory requirements.

⁸ ASIC Market Integrity Rules (Competition in Exchange Markets) 2011 Rule 3.1.1

28. The proposals include the new requirement that new advisers be supervised by an approved supervisor of 5 years experience. The 5 year requirement should not be hard and fast. Licensees should have the flexibility to appoint appropriately experienced people as supervisors. The Paper does not set out any prescribed qualifications, apart from experience. There will need to be many more approved supervisors than there are existing Responsible Executives or Responsible Managers. Presumably these would be senior advisers. Since management duties may eat into otherwise revenue-producing activities of senior advisers, there may be a danger non-revenue writers like administrative, operations or compliance officers will be forced to become Authorised Supervisors. Such people would rarely have the skills to properly supervise and mentor advisers. This would not be a good outcome for firms, and may impact adversely on investor protection.
29. In the dealing room environment, there already exists a natural mentoring environment. Advisers usually start in a junior role under supervision before any client contact is allowed. After that, conversations are able to be heard by colleagues and managers, so that the natural mentoring continues in any case. In addition, review of correspondence and business written always takes place.
30. The departure of senior advisers from the industry caused by their reluctance to sit the FSCC Exam may also diminish the pool of people available as supervisors.
31. Licensees, especially our Members, already have well established supervisory and professional development structures. Unlike other parts of the industry, like financial planning, market participants have been subject to very strict management and supervision requirements, first by ASX and now (since August 2010) carried on by ASIC⁹. Management and supervision arrangements must be documented, and take into account various requirements, including the Australian Standards on risk management and compliance programs. Supervision must be carried out by registered Responsible Executives. In practice, this has resulted in better supervisory structures than in most other sectors of the financial services industry. The new Supervision proposals should take these structures and arrangements into account.

FOS claims data

32. The Financial Ombudsman Service commenced operation on 1 July 2008. In 2008 it published figures for complaints received in the previous 6 months **1 Jan – 30 June 2008**. This time was in the worst part of the financial crisis. Remarkably, while the Service as a whole recorded a 22.8% increase in new complaints - including a 55% increase in

⁹ ASIC (ASX) Market Integrity Rules Part 2.1

complaints against financial planners – during that six month period there was a **23% decrease** in complaints against stockbrokers¹⁰. Complaints against stockbrokers comprised 10.5% of all new complaints.

33. For the financial year **2008-09** (the year of the *Storm Inquiry*) FOS recorded an overall increase of 33% in new disputes. For this year FOS did not publish complaints by service provider, but by product group, so stockbrokers were included in the figures for securities, derivatives, managed funds, margin loans, etc, together with other providers like financial planners.¹¹ For the financial year **2009-10** FOS recorded an overall increase of 6% in new disputes, to 17,352. This total included 1639 complaints in relation to Investments, of which 134 (or 8%) were complaints against stockbrokers. (By comparison, 58% of investment complaints were made against financial planners.)¹²
34. The most recent figures for complaints against stockbrokers to FOS for the **year ended 31 December 2010** are even more remarkable¹³. During 2010, **53 complaints** were received against stockbrokers, a reduction of over **55%** on the previous year 2009, when **120 complaints** were received.
35. These figures are even more impressive when you consider that on the ASX over recent years there has been an average around 600,000 transactions in cash equities - worth around \$6bn - **per day**. (While trading by retail clients accounts for 20-30% of these figures, they are still significant.)
36. Accordingly, Stockbrokers have attracted a very low rate of client complaints. If this is any indicator of competency, our industry scores very well indeed.

Closing Comments

37. We understand that there would be considerable pressures on the Government to take action in response to the *Storm Inquiry*. However, the danger of the revolutionary changes proposed in CP153 is that they throw-out the good parts of the old system along with the bad. Further, we submit that the generality inherent in the new proposals would be inferior to the existing framework, as enhanced by the improvements that we have suggested. As we have consistently stated, the actions of 2 or 3 licensees leading up to the financial crisis does not justify onerous, costly action against the thousands of firms who were not involved in such misconduct.

¹⁰ Financial Ombudsman Service *Media Release* 10 December 2008

¹¹ Financial Ombudsman Service *Media Release* 30 September 2009

¹² Financial Ombudsman Service *2009-2010 Annual Review*

¹³ Alison Maynard, Ombudsman – Investments, Life Insurance and Superannuation, FOS - Presentation at Stockbrokers Annual Conference Sydney 27 May 2011

38. The experience of the implementation of the *Financial Services Reforms* which commenced in 2004 provides some useful lessons here. FSR was introduced as a generic set of requirements across the financial services industry. Immediately after it commenced, a series of reforms, or 'refinements' was introduced, in order to address the differences in business models and client expectations across the sector, e.g. the differences in service expectations between stockbrokers and insurance brokers. With this experience behind us, we would hope that a more measured introduction may be possible, otherwise there will need to be another period of refinements and changes.

Thank-you once again for the opportunity to comment on these proposals, and for ASIC's willingness to meet with us to discuss the proposals ahead of the formal submissions. We would be happy to discuss these matters further at your convenience. Should you require any further information, please contact Doug Clark, Policy Executive on dclark@sdia.org.au.

Stockbrokers Association of Australia

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