Stockbrokers Association of Australia

18 December, 2015

The Manager
Financial Services Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: professionalstandards@treasury.gov.au

Dear Sir/Madam

DRAFT LEGISLATION AND EXPLANATORY MEMORANDUM – PROFESSIONAL STANDARDS OF FINANCIAL ADVISERS -SUBMISSION BY STOCKBROKERS ASSOCIATION OF AUSTRALIA

The Stockbrokers Association of Australia Limited ("the Stockbrokers Association") appreciates the opportunity to provide these comments to Treasury in respect of the Exposure Draft of the Corporations Amendment (Professional Standards of Financial Advisers) Bill 2015 (the "Draft Bill") and Draft Explanatory Memorandum ("Draft EM").

The Stockbrokers Association remains supportive of the broad thrust of the Government's proposals incorporated in the Draft Bill. However a number of questions and concerns have been expressed about the framework that has been set out in the provisions of the Draft Bill and Draft EM.

The views of our members are more fully explained below in this Submission.

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EXECUTIVE SUMMARY

- The SAA is broadly supportive of the proposed regime for professional standards, but concerns exist about some aspects of the Draft Bill and Explanatory Memorandum.
- The SAA supports the incorporation of Pathway 1 into the Code of Ethics framework. However the Pathway 2 option, together with the Model Code of Ethics, will create an incentive for licensees to bypass Pathway 1.
- There is a real and not remote risk that the combination of the Model Code and Pathway 2 will erode existing Professional Associations, and lead to the contrary outcome of weakening professional standards.
- The SAA remains of the view that the national exam will be an additional cost to the industry with no appreciable benefit.
- There needs to be an appropriate transitional pathway as an alternative to the bachelor's degree requirement, for existing advisers that recognises prior learning and experience and that does not mandate extensive further studies, particularly for older, experienced advisers. One approach could be for an adviser's Industry Association to provide a Tertiary Equivalent Accreditation based on (1) Courses undertaken, (2) Length of time in the industry and (3) CPD history.
- Advisers who obtain Tertiary Equivalent Accreditation should be exempt from sitting the proposed national exam.
- The Professional Year requirement should have flexibility built in, to cater for firms of different size and scale. Advice should be permitted during the PY subject to an appropriate monitoring, supervision and sign-off regime.
- The SAA does not agree with the proposed structure and governance arrangements of the Standard Setting Body (SSB). We support a different structure and Board composition for the SSB.
- The definition of "Professional Association'' needs to be tightened by requiring a "substantial" threshold. ASIC to certify what is "substantial."
- The existing Professional Associations have been the major force up until now in setting and raising standards in the industry. Hence, their exclusion from any influence on the direction of the SSB is hard to understand.
- The funding model for the SSB should be equitable across industry and not create a financial cost that will drive retail financial advisers out of the market.
- The existing Codes of Ethics of Professional Associations will be eroded by the Proposed Model Code framework. The SAA supports a variation that will permit existing Professional Association Codes to be approved and remain on foot if they contain the mandatory provisions of the Model Code
- There are some minor changes to the Register obligations required.
- The identified cost offsets that equate to the costs of implementation require some more explanation.

PRELIMINARY COMMENTS

The Stockbrokers Association has previously given broad support to the action that the Government foreshadowed to raise professional, educational and ethical standards of financial advisers, to address in a decisive manner issues that have arisen in some sectors of industry in recent years.

This support has been subject to reviewing the detail of the proposed legislation.

Whilst much of the Draft Bill and EM has been drafted along the lines of proposals that have been foreshadowed, there are aspects of the Draft Bill and EM that cause the Stockbrokers Association a considerable amount of concern.

The proposal for a single Model Code and the Pathway 2 licensee model could lead to the result that the role of existing professional associations, such as the SAA, is significantly weakened. We appreciate that this may not have been the intention of the Government, nevertheless our members consider that there is a real and not remote probability that this outcome may result. *This also opens the door for some "self-regulation" by individual licensees, and we do not believe this would be a wise outcome for either the industry or the wider community.*

Professional Associations have been the major force for raising and maintaining professional standards in the financial advisory sector up until now. Both the Parliamentary Joint Committee (PJC) Proposals and the previous Government's Bowen Code Approval frameworks sought to recognize and leverage off the work of the existing professional associations.

It would be a bad outcome if the Government, in seeking to create a single national standard across the industry and to plug the gap for those parts of the advice industry that were not before now covered by any standards framework, achieved the perverse outcome of eroding the existing professional associations (akin to throwing the baby out with the bathwater.)

It may be that the issues can be resolved with further analysis and some drafting solutions. We have concerns about the extremely truncated timetable that has been released for both consultation and enacting of the legislation.

The deadline of 4 January 2016 has not allowed time for sufficient consultation with our members or the opportunity to devote the usual effort to finalise and consult on a response to the Draft Bill and EM.

We endorse the Government's desire to take action as swiftly as possible to introduce a stronger regime for professional standards to restore the public's perceived lack of confidence. *However, it is critical that the Government spend sufficient time to get the details of this regime right, as the regime will have a significant impact on the careers of many advisers, and on many businesses.*

The Government will face criticism if it rushes to enact legislation for the sake of meeting an arbitrary timetable if the result is a framework that gives rise to many unintended or unforeseen consequences, which then necessitate a series of ongoing legislative fixes. Far better to pause now and spend some time in consultation with key stakeholders. The industry's experiences with the FOFA legislation are fresh in its mind, and there is no real interest in a repeat of that experience. A repeat of the FOFA experience could further erode the public's perceived lack of confidence.

I. EDUCATIONAL STANDARDS

(a) Registration Exam

The Stockbrokers Association has not been supportive of the concept of a single national exam in prior submissions on this area.

In our view, having a single exam that covered the whole spectrum of financial advisers, from insurance brokers, financial advisers, stockbrokers, CFD advisers, and so on, would need to be so general as to be of limited value as a true test of professional standards.

The benefit to investors and to the industry of the proposed reforms arise from the introduction of the university degree requirement, the Professional Year and the ongoing CPD obligations. *Once those are taken into account, the Association has never seen what additional value a generic national exam would add to the equation.*

In the Association's view, a minimum standard exam will have no relationship to the ability to provide financial advice.

We note that the national exam has been retained as a component of the new framework.

The Association remains of the view that the national exam will be an additional cost to the industry with no appreciable benefit. In fact, based on previous views expressed, the *concern is that such a requirement in conjunction with all other proposed requirements may see an exodus of long-serving, highly experienced advisers from the industry*.

This, at a time when such experience will be required to mentor new advisers through their Professional Year, as well as continuing to navigate retail clients through very challenging domestic and global markets. This will be a bad outcome for the industry, for clients and for Australia.

The SAA therefore recommends that Advisers with at least 10 year's industry experience who obtain Tertiary Equivalent Accreditation from their relevant Industry Association should be exempt from the requirement to sit the proposed national exam. Tertiary Equivalent Accreditation is explained in 1 (b) below.

(b) Bachelor's Degree or Tertiary Equivalent Accreditation

The Stockbrokers Association in previous submissions noted the arguments favouring the raising of educational standards for financial advisers to a Bachelor's Degree. The SAA noted that it was not entirely clear whether there would be any restrictions on which Bachelor Degrees would be considered to be acceptable and which might not.

We note that the Draft Bill now proposes that this question, and the question of what is considered to be an acceptable equivalent qualification to a Bachelor's Degree, are to be determined by the new Standard Setting Body (SSB).

The Association has previously called for some flexibility as to what is considered to be a relevant Bachelor's Degree. Included amongst top tier equities research analysts within stockbroking firms are people who were formerly geologists, chemists, scientists, engineers, accountants and teachers, and hold Bachelor's Degrees and Post Graduate qualifications in such fields.

There is an argument against being overly narrow or prescriptive about the range of Bachelor Degrees that could be considered relevant to being a good stockbroker. What is of as much significance is the industry-related qualifications and training, and ongoing professional development undertaken throughout an adviser's career. *The legislation should therefore acknowledge that many tertiary courses and industry qualifications undertaken to this point are of very high quality, and they equip advisers with valuable skills that may be a proxy for a Degree albeit not a formal Degree.*

An additional consequence of an overly narrow view of the range of acceptable Bachelor Degrees is the impact this would have on the transitional period. Depending on what is in the list of acceptable Degrees, there could be many thousands of the estimated 22,000 financial advisors who could be faced with undertaking transitional qualifications in the two year period prior to 1 July 2019, as presently provided for in the Draft Bill.

An alternative approach is for the legislation to provide that existing advisers with at least 10 years' experience must have either a Degree or a Tertiary Equivalent Accreditation. The Tertiary Equivalent Accreditation could be provided by the adviser's relevant Industry Association based on:

- *Courses undertaken*
- *Length of time in the industry*
- *CPD history*

Furthermore, Advisers with a Tertiary Equivalent Accreditation from their relevant industry Association would be exempt from having to pass a national exam for the reasons outlined in 1 (a).

Consideration also needs to be given to the ability and capacity of current course providers or Universities to facilitate the transitional training and offer relevant courses for candidates to enter the financial services industry post 1 July 2017. The government would know full well the current funding and capacity constraints that already exist in the education sector and this could exacerbate the problem.

(c) Professional Development Year

The Association has previously indicated support for the concept of a Professional Development Year (PDY), subject to qualifications.

There needs to be recognition that smaller firms will not have the same level of resources available compared with larger firms for a highly structured professional development year. The smaller the firm, the more likelihood of there being a need for new starters to make a contribution to the work needing to be performed within the firm during the time that they will be undertaking their professional year.

We note that the Draft Bill at Section 921C precludes a person from providing any personal license to retail clients until all of the education standards are met. We strongly submit that this should be modified to clarify that it does not preclude trainees who are undertaking their Professional Year from providing advice subject to the appropriate monitoring, supervision and sign off requirements of the Professional Year. The best way of gaining experience is to actually perform the relevant tasks under supervision.

We note that the Professional Development Year requirements are to be set by the Standard Setting Body (SSB). The PDY requirements need to be flexible and able to be tailored to suit firms having different size and scale businesses. The focus should be on

appropriate supervision of staff during their PDY and beyond. Legislation should be drafted in a way which permits this.

As mentioned in our previous submissions*, it is not in the interests of the industry or of investors if large firms or large financial institutions are the only effective entry pathway into the industry for new advisers.* This would be anti-competitive and would harm small advice firms. A consequence of this could be to force small firms to merge or sell out to larger institutions. This in turn would reduce innovation, as it is the smaller firms that are able to be more nimble, agile and willing to embrace new ways of doing things to reduce costs. Given that the Turnbull government has signaled its intention to foster innovation, it would be incongruous if the proposed legislation actually stifled innovation, albeit unintentionally.

(d) Continuing Professional Development

The Stockbrokers Association has consistently supported the introduction of CPD requirements as a standard across the whole financial advice spectrum. As previously noted, the Stockbrokers Association already mandates 20 hours CPD per annum as a standard for its members. (Of these 20 hours, 8 hours are Compliance related CPD.) This is consistent with the CPD requirements imposed under the Market Integrity Rules on the Responsible Executives of Market Participants.

The Association notes that the CPD requirements are to be established by the proposed Standard Setting Body (SSB). The Association supports a 20 hour CPD requirement as being appropriate. A higher figure would not necessarily achieve anything more, in our view.

The Association hopes that CPD requirements are consistent across the financial advice spectrum in terms of content (i.e. formal versus informal, compliance hours, etc). It should not be easier to complete mandatory CPD in one industry sector compared with another.

The Association strongly submits that CPD should not be confined to formally delivered training courses. There is a range of different sources of CPD that have been recognized as having been effective over time in the stockbroking industry, such as professional annual conferences, company presentations, morning meetings, internal compliance training, online training and self-study. These should continue to be satisfactory methods of achieving CPD, subject to reasonable limits for relevant sub-categories.

Dual memberships within the financial services industry are common. For example, members of the SAA may also be CFP and / or CPA qualified and undertake requisite

CPD to meet all qualifications. It is vital the current degree of flexibility and cross over remains.

II. STANDARD SETTING BODY

The Association has a number of reservations about the provisions relating to the Standard Setting Body (SSB), including in relation to its proposed structure and governance arrangements. Depending on the approach that the Government intends on taking, it may be more appropriate for the SSB to be constituted as a statutory body as opposed to a Corporations Act company.

1. Membership.

The Draft Bill is silent about the proposed membership of the SSB. This differs from, for example, the Securities Exchange Guarantee Corporation (SEGC), where the Corporations Act makes provision for who the members can be. In the absence of any provision, it is not clear what the membership will be or is expected to be.

We assume that the intention may be that the professional associations would wish to become members of the SSB.

Firstly, we note the definition of "professional association" in the Draft Bill, namely "a body or association that represents a section of the financial services industry". This definition is too broad, and needs some qualification. There is nothing to stop organizations with no real substance being set up by individuals with an ulterior motive purporting to represent a section of the industry.

There should be a "substantial" threshold in the definition, and ASIC should be asked to certify that an association is "substantial."

Secondly, it is not clear what benefit would be gained by becoming a member. Members are not able to elect the Board of Directors. This is clear from Section 921MA of the Draft Bill, which provides that the Minister appoints the independent Chair and that the Directors are appointed by the Board. Section 921MA also prohibits a Director from holding any managerial or executive position in any professional association or consumer association.

If members cannot appoint the Board and are not able to have any say in the running of the SSB, then it is questionable why any person, least of all the professional associations, would consider value in becoming a member.

If the above requirements are an essential feature of the SSB, then in our view the SSB would be better constituted as a Statutory Body under the Act rather than as a company.

If the Government wants the SSB to be set up, funded and run by industry, then the company limited by guarantee structure would only be feasible if the members had the usual powers that go with membership.

2. SSB Directors.

We refer to the Association's previous submission on this issue. It follows that we do not support the Board structure as foreshadowed in the Draft Bill. The only differences from the previous proposal is the reduction of the consumer representation from 3 to 2, and the new Board position for a person with an ethics background.

The most important function of the SSB is the setting of educational standards. In our previous submission, we argued that first and foremost, *professional education should be industry relevant and should have gravitas*. The Association believes that the plethora of commercial education offerings lacking meaningful content that emerged around RG 146 should be avoided this time around. For these reasons, industry (through the Professional Associations) should appoint the majority of the Board.

We do not understand why the proposed SSB Board structure seeks to stamp out any connection with Professional Associations. The problems that have occurred in financial advice have stemmed from advisers that have operated without standards and outside the oversight of a professional association. *As mentioned earlier, the Professional Associations have been the only consistent force for raising standards in the financial advice industry.* The Draft SSB structure not only fails to recognize this, it seems to regard the existing Associations as part of the problem.

We note that it is proposed that the Minister is to appoint the independent Chair. There is no reason why the Chair, the ethics Director and one Consumer Representative (we do not support there being two) should not be sufficient Board representation to ensure an adequate voice for the non-industry point of view.

In addition, we reiterate our comments from our previous submission, namely that we would have thought that ASIC, whose function includes the oversight of licensees and advisers, including competency and training obligations, ought to be represented on the SSB Board.

We also suggest that sub-committees of the board be established to assist with the significant amount of development work and consultation with industry, ASIC, Government etc.

3. Funding

We note that industry has been asked to provide a model for funding the SSB to the Government.

There are issues with placing the funding obligation on the existing Associations. Firstly, this would create the significant problem of *free riding by those financial advisers who do not wish to be a member of an Association*. As previously noted, this is precisely the part of the industry that has given rise to the regulatory failure that is now being addressed. They should not be able to avoid meeting their share of the costs of the new standards framework. Financial contributions should be obtained from the financial services industry as a whole.

Secondly, there is the issue identified above relating to membership and governance of the SSB. It is unacceptable to ask Associations to fund a body over which they have neither influence nor control.

It is difficult to comment any more at this point without more detail of the precise funding arrangements that will apply. Any funding model should be equitable across the industry and not create a financial cost that will drive retail financial advisers out of the market.

The Government is also best placed to understand the number of AFS Licensees who have a license condition enabling them to deal with retail clients and / or provide advice to retail clients. Perhaps that is a starting point.

The government also needs to take into consideration the current Treasury ASIC Funding cost recovery consultation still to be finalised and the current cost recovery framework in place for Market Participants. Both of these either currently or will likely impose significant cost burdens on licensees and particularly Market Participants.

We therefore propose that the funding model considered for the SSB must not be considered in isolation to any existing or proposed models. Perhaps this has been considered as part of the Treasury regulatory offset mentioned in Table 1?

III. CODE OF ETHICS

We note the new framework is based on a Model Code of Ethics applicable to all advisers. This represents a change from the previous framework advised to industry.

We note that the Parliamentary Joint Committee (PJC) Proposals proceeded on the basis of mandating membership of professional associations in order to raise standards of advisers across the industry. The prior Code Approval framework put forward under Minister Bowen in the previous Government provided for the approval of Codes of Ethics by ASIC. This would have enabled existing Professional Associations to have their codes approved and applied to members. Advisers were required to sign up to an approved Code.

The Draft Bill however whilst allowing for Professional Associations to base their Code on the Model Code, and add supplementary additional requirements for members, contains a prohibition on any variation or amendment to the Model Code.

The Association is concerned that Model Code arrangements are likely to weaken the role of Professional Associations at the very time that the Government is trying to raise professional standards.

We note that Pathway 1 was intended as a way of leveraging off the existing Professional Associations, and ensuring that they had a role to play, in the new Standards framework.

The concern that members have expressed is that the availability of Pathway 2 is likely to prove a more attractively simple option for licensees, even those who may be supporters of Professional Associations. At the end of the day, having a Code that is limited to the Model Code does not have any complications, as opposed to an Association's Code that is likely to have additional Practice standards and Guidance to be read in addition to the Code.

Pathway 2 therefore presents a less complicated model, which may be a more compelling choice, particularly for a licensee which has advisers falling into more than one existing Professional Association (some advisers may even be members of more than one Association on their own, e.g. FPA and TPB, SAA and CPA.).

There is a real risk therefore that the proposed Model could trigger a decline in the membership of Professional Associations.

If Professional Associations decline in size, then there could be a snowballing impact in that the cost of delivering an Association's code monitoring function would need to be recovered from fewer participants. This could end up creating a financial incentive for more licensees to choose Pathway 2 for reasons of cost. Pathway 2 also appears to open the door for more self-regulation, which may be a more expedient and cost effective solution for some of the larger industry players and yet they may be precisely the organizations that need a greater degree of external oversight.

The SAA therefore recommends that existing Professional Association Codes be automatically approved if they contain within them the required provisions which comprise the content of the Model Code i.e, the Model Code becomes the minimum basis for any Professional Associations Code.

IV. REGISTER

The Association has some limited issues to raise in relation to the provisions governing the Register of relevant providers.

1. The Association does not support the requirement for annual notification that an adviser had completed their CPD requirements. This is an unnecessary administrative burden, and also runs contrary to recent red-tape removal initiatives.

   Instead, a licensee should only be required to notify ASIC in cases where the CPD requirements have not been met or like any other breach, required to be reported if considered to be significant.

2. The requirement in section 922HB of the Draft Bill requiring a notice to be lodged in the case of an "alleged breach" is unduly onerous and potentially unfair. It should be deleted or at least modified to "significant breach."

V. TRANSITIONAL PROVISIONS

In our previous submissions, we have consistently argued for the recognition of equivalent prior learning and in favour of accommodating older, experienced advisers.

It is important that the new system incorporates sufficient flexibility to cater for experienced advisers. There needs to be acknowledgement that a trusted adviser of 20 years standing with an impeccable record of service but no formal qualifications (apart from perhaps RG146), is much more valuable to clients than a new adviser fresh out of university with little or no experience. There is also an insinuation in this that the regime in the past was wrong and no longer appropriate. Formal "degree" education is just one piece of the puzzle.

Accordingly, through recognition of prior learning or some other mechanism (such as an individual certificate of *Tertiary Equivalent Accreditation from an industry association*) to vouch for the senior adviser's knowledge and experience, there needs to be a way to allow these advisers to remain in the industry. Otherwise great experience and knowledge will be lost from the industry to the detriment of clients. Moreover, to impose the 'new starter' requirements on *all* advisers would run the risk of discriminating against experienced advisers on the basis of age.

We note that the alternative transitional pathway is to be set by the SSB.

We are concerned with the wording of section 1546B(1) (b) of the Draft Bill, namely, that an adviser must, in the alternative, have completed "…one or more courses determined by the standards body to give the provider qualifications equivalent to the standard".

This drafting would appear to limit the alternative pathway for existing advisers to the completion of courses that equate to bachelor's degree standard. Whatever this pathway may be, there needs to be flexibility in this based on the products and services on which a person is able to advise, or currently licensed to advise on eg., advising on listed securities versus complex Superannuation and Life Insurance issues.

We reiterate our arguments that there must be an alternative pathway, at least for experienced advisers above a certain age, to be granted recognition if they can demonstrate the requisite knowledge, without the need for more courses to be undertaken. *The Draft Bill needs to provide for a Tertiary Equivalent Accreditation from an Industry Association to enable this. See I (b) above.*

The *Tertiary Equivalent Certification from an Industry Association could be recorded on the Register*. It should then be up to the clients to decide whether they want to continue to deal with their broker who has advised them for the last 25 years and made them money, or to go to another adviser because they have a university degree.

As mentioned earlier, if the alternative pathway is limited to the completion of certain courses, the ability to complete those courses within the 2 year timeline set under the legislation would be highly problematic, given that these courses will need to be

undertaken part-time. This is apart from the complications that would be caused if there were in the order thousands of advisers who might need to undertake those courses. This would also be on top of any other requirements to be met under the new TASA requirements for tax (financial) advisers. As indicated earlier, the Government would fully understand the funding and capacity constraints on Universities, so consideration of this added burden needs to be considered.

The table estimate indicates individuals would have a potential cost of $87.8, albeit supposedly fully offset. How can this figure be estimated when there is no agreement / standard of what the approved degrees may be, no estimate of what the industry wide exam may cost and then for those who do not have an approved degree, no detail in respect to courses they may need to complete to achieve the approved standard?

We also refer back to our earlier comments regarding the current ASIC Cost recovery proposal that hasn't been finalised, unless this has been thrown into the mix as part of the regulatory offset identified within the Treasury portfolio.

VI. COST OFFSET EQUATION

Members have raised questions about *Table 1: Regulatory Burden and cost offset estimate table* at page 47 of the Draft EM.

It is noted that the estimated Cost of $165.1 million is fully balanced by regulatory offsets identified from within the Treasury Portfolio, leaving a regulatory burden of $0.

Members are interested to know what are the "regulatory offsets" that have been identified? We are not in a position to comment on the accuracy of the estimated cost of $165 million, nor, in the absence of any detail about the cost offsets, on the total regulatory burden of the new framework.

CONCLUSION

The Stockbrokers Association appreciates the opportunity to provide this Submission to Treasury on these significant proposals.

We reiterate that the submission has been prepared on an expedited basis, and that there may be additional issues that are identified upon further and closer consideration of the Draft Bill and EM. There may also be some further suggestions identified for possible ways to address some of the issues.

We would be happy to discuss any issues arising from our submissions on this issue, or to provide any further material that may assist. Should you require any further information, please contact Peter Stepek, Policy Executive, on (02) 8080 3200 or email pstepek@stockbrokers.org.au.

Yours sincerely,

ANDREW GREEN
Chief Executive