

13 May 2015

Financial Services Unit
Financial System and Services Division
Markets Group
The Treasury
Langton Crescent
PARKES ACT 2600

Initially by email to: professionalstandards@treasury.gov.au

Dear Sir

PROFESSIONAL STANDARDS OF FINANCIAL ADVISERS

We refer to the Consultation Paper released on 25 March 2015, on recommendations of the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into proposals to lift the professional, ethical and educational standards in the financial services industry. The Professional Standards Councils¹ (PSC) are pleased to have the opportunity to respond to the proposals in the context of the state and territory Professional Standards Legislation² (PSL), which has been operating for 21 years.

In this response to the Consultation Paper we have initially sought to clarify the powers and statutory role of the Professional Standards Councils in this covering letter. We have then attached our responses to the questions raised in the Consultation Paper, particularly section 8 which in particular refers to the role of the PSC at section 8.2.

The PSC acknowledges and thanks the PJC for their consideration of our possible role in professional standards, noting where the PJC inquiry and the Consultation Paper indicate that the '...PSC occupies a pivotal role in the PJC model through its power to approve professional associations³'. The PSC confirms that it is positioned to assist the government to improve the professional standards of financial advisers but with the important clarification that this can only be where an occupational association with financial adviser members can meet the requirements of the Professional Standards Legislation.

We are concerned that the PJC may have a view that the PSC can assist by approving all or even any associations by applying a lower threshold of assessment or by only considering some elements of our legislation. The powers of the PSC are discrete and prescribed in the PSL. Notably, they do not include the approval of associations, but they do include the approval of professional standards schemes operated by an occupational association pursuant to the PSL.

¹ The Councils are constituted under state and territory professional standards legislation. There are eight Councils – one in each state and territory. Each Council's members are appointed by the Attorneys General of each state and territory. Each Council has 11 members. NSW and Victoria nominate two members each, while all other state and territories and the Commonwealth nominate one member. All states and territories have agreed to appoint the same 11 members to their Councils. Members are appointed for terms of up to three years, and can be reappointed at the end of their term.

² Professional Standards Act 1994 (NSW); Professional Standards Act 1997 (WA); Civil Law (Wrongs) Act 2002 (ACT); Professional Standards Act 2003 (Vic); Professional Standards Act 2004 (NT); Professional Standards Act 2004 (Qld); Professional Standards Act 2004 (SA); Professional Standards Act 2005 (Tas); and related regulations.

³ Para 62, p20.

The PSC is empowered to encourage and assist in the development of self-regulation of occupational associations in respect of the following professional standards⁴ and does so through the specialist regulatory agency of the PSC, the Professional Standards Authority:

- (i) codes of ethics,
- (ii) codes of practice,
- (iii) quality management,
- (iv) risk management,
- (v) resolution of complaints by clients,
- (vi) voluntary mediation services,
- (vii) membership requirements,
- (viii) discipline of members,
- (ix) continuing occupational education

As an important aside, PSL also precludes the PSC from the giving of advice to an association about occupational standards contained in any other Act or statutory instrument⁵, such as the Corporations Act 2002 (Cth).

For the PSC, approval of an occupational association's scheme does not include approval of any of these discrete elements of professional standards. They cannot be individuated in our process. All elements must be considered at the same time. This is why generally the process of a scheme application takes more than 1 year during which time the Professional Standards Authority works with the occupational association

The PSL establishes a means to improve consumer confidence through schemes that work to improve professional standards, and assure reasonable compensation by limiting occupational liability consistent with the evidence and actuarial analysis of historical claims. The PSC may approve a scheme, which may limit a person's occupational liability only after taking into consideration the elements prescribed in the PSL⁶:

- (a) all comments and submissions received in the course of public notification,
- (b) the position of persons who may be affected by limiting the occupational liability of members of the occupational association concerned,
- (c) the nature and level of claims relating to occupational liability made against members of the occupational association concerned,
- (d) the risk management strategies of the occupational association concerned,
- (e) the means by which those strategies are intended to be implemented,
- (f) the cost and availability of insurance against occupational liability for members of the occupational association concerned, and,
- (g) the occupational association policy regarding professional indemnity insurance standards and quality.

Only occupational associations that can evidence and demonstrate a high level of initial and ongoing self-regulation, in compliance with the requirements of the PSL, may have a scheme approved.

We acknowledge that this is both time consuming and complex for most associations because the gift of the crown that flows from PSC approval (a professional standards scheme, gazetted in law, which limits the civil liability of participants) is recognised as a highly valuable one. Consequently, approval of a professional standards scheme is carefully considered and not always given. As a

⁴ Professional Standards Act 1994 (NSW), s43(1)(d), and mirrored provisions in the PSL.

⁵ Professional Standards Act 1994 (NSW), s43(2), and mirrored provisions in the PSL.

⁶ Professional Standards Act 1994 (NSW), s10, and mirrored provisions in the PSL

consumer protection regime it is generally recognised as being reserved for those groups that meet an established and stringent criteria and should not be diminished

At the time of writing there are no schemes approved for occupational associations in the financial services sector (although the accountants' schemes include limited financial services activities in respect of limited license arrangements approved by ASIC).

It is our firm view that the benefits of PSL, in particular limitation of liability would bring a welcome degree of compensation assurance and confidence to what we understand is a problematic area for consumers of financial services. In our long experience, properly considered professional standards schemes and the liability capping arrangements of PSL deliver better quality professional indemnity insurance arrangements (standards of insurance and responsive policies) and this seems likely to be very useful in financial services. However, as stated, this should be reserved for those groups that demonstrate their capacity under the full weight of our legislation. We emphasise that, as a matter of law and principle, PSL is open to applications from occupational associations in the financial services sector who can meet those requirements. What's more we would anticipate that the Commonwealth and its agencies would support such an application, should it be made.

The Professional Standards Councils looks forward to assisting the government with this important strategic initiative, consistent with the provisions of the Professional Standards Legislation.

Yours sincerely



Brian Rayment QC
Chairman
Professional Standards Councils

Feedback sought — the PJC model

Under the PJC model, ASIC, licensees, the PSC, FPEC and the professional associations will have a role in raising standards and ensuring these are met on an ongoing basis.

Question 1.3

Are the lines of responsibility clear under the PJC model?

The PSC does not approve associations or their professional standards policies and procedures. Rather, it approves at schemes proposed by associations for adoption under the PSL. However, in considering a proposed scheme, the PSC has regard to the professional standards policies and procedures prescribed by the association for its members. While able to advise associations in the process of a scheme application the PSC has limited powers to publish guidelines regarding professional standards. In addition, the PSL does not empower PSC with an ability to collate or publish a register of associations who are intending to apply for a scheme. In the contrary, that information is confidential.

Feedback sought — ongoing professional development

The PJC model requires mandatory ongoing professional development for financial advisers.

Question 7.1

What are the practical implications of the proposed ongoing professional development requirements?

Referring to paragraph 57, the PSC does not and cannot publish standards relating to ongoing professional development. It does, however, take into account the professional development regime proposed by an applicant association on its members as a condition of membership of the association and its proposed PSL scheme.

Feedback sought — professional and ethical standards

Code of ethics

The PJC recommended that professional associations be required to establish codes of ethics that are approved by the PSC.

Question 8.1

What are the practical implications of having each professional association create its own code of ethics? For example, what are the implications of having multiple codes as opposed to a single code?

In the experience of the PSC, several occupational associations within an industry sector can create effective Codes of Ethics and Codes of Practice. Good examples of this phenomenon are lawyers (state-based associations) and accountants (national, activity-based associations). It is not as well established as to how multiple codes would operate within a single employer as typically the employer will respond to a single code for all employees. So for instance, most Accounting firms will define or identify as a Chartered Accountant firm or a CPA firm.

Question 8.2

What are the practical implications of requiring that a code of ethics be approved by the PSC? Are there alternative approaches that would be more appropriate or effective?

PSL has a statutory model code relating to complaints and disciplinary matters (at Schedule 1 of the PSL). The PSC has the power to approve modifications to the model code¹ proposed by an occupational association. However, the PSC does not have a discrete power to approve a code of ethics. Approval of a code cannot be individuated from approval of the professional standards scheme.

The PSC has published a Model Code of Ethics Principles² which includes principles for (inter alia):

- (i) Generic content of codes of ethics;
- (ii) Process for developing codes of ethics;
- (iii) Codes of Ethics: Analysis & Justification;
- (iv) Professions and codes of ethics;

¹ S38(1).

² <http://www.psc.gov.au/sites/default/files/Model%20code%20of%20ethics%20principles.pdf>

Role of the PSC

The PJC model uses the PSC as a key mechanism to drive continuing improvements in the professional standards of the financial advice industry. Under the PJC model, a professional association will need to have schemes approved by the PSC in order for its members to be registered as financial advisers, and for the association to be a member of FPEC.

Pursuant to the PSL, it is not necessary for all members of an occupational association to be members (or participants) of the occupational association's approved professional standards scheme, and indeed it is rare for that to be so. They are typically separate. Membership and classes of membership of an occupational association do not automatically create membership (participation) of the occupational association's approved professional standards scheme, as participation in a scheme requires compliance with the occupational association insurance standard, including but limited to, the direct benefit of either professional indemnity insurance or access to defined business assets, or both. Equally, an approved scheme could accept participants from one or more occupational associations.

Question 8.3

Is the PSC the appropriate body to drive improvements in professional standards in this industry? Are there alternative arrangements that would be more appropriate or effective?

The PSL is designed to improve the professional standards of the occupational associations that operate an approved professional standards scheme. For that to occur the occupational association must be able to demonstrate and evidence to the PSC that it has the strategy and resources to self-regulate, on an ongoing basis, in compliance with the requirements of the PSL. For example, the occupational association must be able to ensure that members of the scheme comply with the occupational association's professional standards.

The PSC is not empowered to improve the professional standards of persons who are not members of an occupational association with an approved scheme, or for the members of an occupational association that does not have a professional standards scheme. At the time of writing, there are no occupational associations from the financial services sector with a scheme.

Question 8.4

What are the practical implications of having the PSC perform this role? For example, how would the PSC interact with ASIC?

The Parliamentary Joint Committee has suggested a model for improving the professional standards of financial advisers. It would appear that the roles and duties of the statutory regulator with oversight responsibility for the Corporations Act 2002 (Cth) and the Professional Standards Councils

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with statutory duties and powers in respect of the 8 state and territory Professional Standards Legislation, should be complementary.

Assuming a scenario where one or more occupational associations were granted a scheme in accordance with the PSL, the PSC would be required to monitor the enforcement by the association of professional standards of the scheme participants and association members, and also monitor the compliance by an occupational association with its own risk mitigation strategies. The PSC has the power to take limited enforcement actions in respect of schemes such as amending or revoking a scheme. Conceivably, the current compliance and enforcement (scheme assurance) capabilities of the Professional Standards Authority would need to be enhanced in line with the increase in participants of professional standards schemes.

Question 8.5

What are the practical implications of requiring professional associations to hold a PSC-approved scheme?

Assuming a scenario where one or more occupational associations were granted a scheme in accordance with the PSL, the occupational associations would need to maintain the elements of professional standards required in the PSL and ensure that the association members are complying with the professional standards, including:

- (i) codes of ethics,
- (ii) codes of practice,
- (iii) quality management,
- (iv) risk management,
- (v) resolution of complaints by clients,
- (vi) voluntary mediation services,
- (vii) membership requirements,
- (viii) discipline of members,
- (ix) continuing occupational education

On an annual basis, the occupational association is required to report to the PSC on their compliance with the PSL and their member monitoring, and review and improvement, of their professional standards. The association must pay an annual statutory fee on a per scheme member basis in accordance with the applicable state regulation. At the expiry of a scheme, or every 5 years, whichever less, an association must re-apply for a scheme to the PSC, which also has a statutory fee.

Approval of a scheme under the PSC has previously meant capped liability for participants.

Question 8.6

Is it appropriate that liability in relation to financial advice/services be limited at this time? Is limitation of liability a necessary element for the operation of the PJC model?

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The PSL creates schemes for the limitation of occupational liability conditional on compliance with professional standards including access to quality compensation. In the PSL the two aspects are indivisible, co-constructed, and rely on each other to provide an optimised and maximised overall community regulatory reflex. In the conception of the PSL to allow limitation of liability in isolation from compliance with professional standards including access to quality compensation would be considered by the PSC to be sub-optimal.

Question 8.7

What are the practical implications of capping liability? For example, what changes to Commonwealth and/or state and territory legislation would be required?

In the 21-year history of the PSL, the PSC is aware that the liability of capping has only been exercised extremely rarely and possibly in less than 10 cases, such is the construction of the scheme and the risk management strategies and professional standards that are the strongest aspect of the schemes. In respect of changes to legislation, reflecting at a theoretical level, there remains the probability that occupational liability based in a current or future Commonwealth Act may conflict with a capping scheme created as a regulation under the PSL and accordingly that scheme may not be applicable in such cases. In the context of PSC considerations of a scheme application, applicants are required to provide a report of any such possible conflicts in their application. We are already pursuing, as a matter of better statutory interaction rather than only related to this proposal, changes in the range of Commonwealth statutes, to ensure that any conflict of laws is not an impediment to future interaction.

Question 8.8

Would an alternative arrangement, under which a scheme's approval would not limit liability, be practicable?

Such an arrangement is not possible under the PSL at the current time.

Feedback sought — other issues for consideration

Timing

The PJC recommended an implementation timeline that would see FPEC establish education standards by June 2016, professional associations operating under a PSC approved scheme by 1 January 2017 and all advisers (new and existing) to be fully registered by 1 January 2019.

Question 9.6

Are there any particular elements of the PJC model that present timing challenges?

The Consultation Paper proposes a model where all financial services professional associations are approved by PSC by 1 January 2017. We submit that this is not possible either in scope or timeframe. In terms of scope, it is realistic to consider that only a small number of occupational associations have the ongoing resources and economies of scale to operate a scheme. In terms of timeframe the PSL Application Guidelines suggest a 1 year application period from submission of draft application to gazettal of the scheme but this does not include the work that an association is required to undertake before they initiate an application and does not always indicate the time required to carefully consider a scheme application by the PSC. There are many steps including wide public consultation. PSC anticipate that an occupational association without highly developed and operational professional standards would take at least 3 year to evolve to a position of submitting a successful application. Given the sensitivity and consumer protection risks of this particular industry, it is conceivable that the analysis and consideration process may take even longer than normal.

Feedback sought – Regulation impact

To help inform the RIS process, which will consider a range of policy options (one of which would likely be the introduction of the PJC model), we are seeking information on the current structure and education of the industry.

Question 5:

What are the likely costs (labour and non-labour costs) associated with the various elements of the PJC model? These costs could include, for example, the direct costs to:

- individual financial advisers;
- professional associations; and
- licensees.

Are costs likely to vary between different size advice firms, different professional associations, etc? If so, how?

The direct costs to occupational associations of applying for, acquiring, and maintaining a compliant and well managed professional standards scheme are material in direct labour costs whether internal or outsourced. The PSCs have not undertaken a benchmarking study of the costs of

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acquiring and maintaining a scheme although as a benchmark estimate, an occupational association with 5000 members may need to invest up to \$50 per member per year in the application and ongoing support of a scheme, in addition to the \$50 per member per year of statutory fees paid to PSC.

There is some evidence to suggest that the higher quality and lower excess professional indemnity insurance required in accordance with a scheme can increase insurance costs in the range of 1-5% at the early stages of an association's professional standards scheme.