



Corporations Amendment (Professional Standards of Financial Advisers) Bill 2015

Exposure draft

Financial Ombudsman Service Australia Submission



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Executive summary

1. The Financial Ombudsman Service Australia¹ (FOS) welcomes the opportunity to comment on the *Corporations Amendment (Professional Standards of Financial Advisers) Bill 2015* (the Bill).
2. FOS supports the initiatives to raise the professional, ethical and competency standards of financial advisers outlined in the Bill. In this submission² we restrict our comments to the proposed framework for implementation of the Code of Ethics. We note, however, that we are generally supportive of the other reforms proposed in the Bill to enhance professionalism in the financial advisory sector.³
3. This submission is based on the extensive experience FOS has as an independent dispute resolution body and through its role in providing code monitoring and compliance arrangements for major industry codes.
4. We support the Bill's objective that "all relevant providers providing advice on all relevant products will be covered by and subject to the same Code and ethical standards". We consider, however, that the current proposals will not necessarily achieve this outcome.
5. To better achieve the stated outcomes and objectives consistent with the broad framework set out in the Bill, we suggest some modifications to the proposed governance and code monitoring frameworks associated with the single Code of Ethics.
6. The changes we propose are consistent with retention of a two tiered compliance scheme model for professional associations or a licensee (or group of licensees) proposed in the Bill, subject to some slight modifications, if the Government decides to proceed with this model. The changes would also be consistent with a single tier model where the code obligations operate through membership of a professional association. We continue to support the important role professional associations play in influencing the ethical and professional conduct and behaviour of their members and individual advisers.

¹ Information about FOS, and the services we provide, is available on our website www.fos.org.au. Overview information appears in Appendix 1 and our [annual review](#).

² This submission has been prepared by the Office of the Chief Ombudsman and does not necessarily represent the views of the Board of FOS. It draws on the experience of FOS and its predecessor schemes in the resolution of disputes about financial services and code compliance and monitoring.

³ As we have set out in our previous submissions, FOS continues to consider that the absence of a compensation scheme of last resort to address unpaid FOS determinations remains the missing element in current Government and industry reforms designed to enhance professionalism to improve consumer confidence in financial planning and advice. Most recently ASIC's report on the professional indemnity insurance market has once again highlighted the inherent limitations of professional indemnity insurance as an adequate compensation mechanism. See, for example, our submission in response to the [Final Report of the Financial System Inquiry](#) in March 2015 and our submission to the [Senate Inquiry into the scrutiny of financial advice](#) in December 2014 and [ASIC's Report 459](#), *Professional indemnity insurance market for AFS licensees providing financial advice*, December 2015.

7. Our modified proposal seeks to ensure greater clarity in roles, reduce complexity and ensure that the Bill's desired outcome of a single ethical standard across all relevant participants in the advisory sector is achieved.
8. The changes we propose in the modified proposal are as follows:
 - a. Establish a single independent code monitoring body. This will help reduce complexity and ensure consistent and transparent application, monitoring and enforcement of the Code of Ethics across all participants in the advisory sector.
 - b. Require clear governance standards be established for a code monitoring body under a scheme consistent with those set out by ASIC in its Regulatory Guide 183⁴. Our experience is that proper governance arrangements are essential for the effective operation of industry code arrangements. This could be achieved by reference in the Bill to the standards ASIC has established under ASIC's regulatory guide.
 - c. The code monitor be appointed by, or be a subcommittee of, the standards setting body and adopt the governance framework for such monitors outlined in ASIC's Regulatory Guide 183. This will ensure a clear link is established between the standards setting body and the code monitor, to enable early identification of industry issues and foster continuous industry improvement.
 - d. The code monitor could operate as an entity with its own secretariat and compliance staff or, alternatively, it could be based on current arrangements for monitoring of financial sector codes where the various code monitoring committees have outsourced secretariat and compliance functions to FOS as the code administrator. We consider the latter model is well understood and accepted in the industry with clear efficiency and consumer benefits.
 - e. The code monitor would also report on aggregated and individual compliance performance against the code's standards and make recommendations for continuous improvement of the sector's standards. This feedback mechanism is important for any code to be transparently administered and be effective in addressing emerging compliance issues.
 - f. A two tiered code compliance monitoring framework could still be adopted, utilising the proposed 'compliance scheme' model in the Bill:
 - o Tier 1 scheme - professional associations would have a co-regulatory relationship with the independent monitor, could undertake an agreed

⁴ ASIC's Regulatory Guide 183 *Approval of financial sector codes of conduct*, available on www.asic.gov.au under "Regulatory Resources".

monitoring plan and report annually on the performance of their members against the code's standards.

- Tier 2 scheme – all licensees or groups of licensees who choose to have the performance of their advisers against the code's standards separately monitored, instead of supporting association membership, would utilise the services of the independent monitor. In this case the code monitor would undertake the direct monitoring of the code by these participants.
 - ASIC would still approve both tier schemes as outlined in the Bill and retain a general oversight role over the adequacy of the code monitoring arrangements by the code monitoring body. Professional register, competency and code breach reporting obligations to ASIC by compliance scheme participants would all remain the same.
 - The modified proposal would also enable the fees payable by licensees for code monitoring to be set commensurate with the costs involved in the monitoring activities and non-compliance risks that may be associated with each tier. This is consistent with a user pays model where the costs to the regulated entity reflect the intensity of regulatory activity.
9. There are only small differences between the model proposed in the Bill and the revised model we recommend. The key differences are that, under the revised model:
- a. Clear governance standards for the code monitor are set out.
 - b. There is one independent code monitor, not many.
 - c. The code monitor is established by, or a sub-committee of, the standards setting body.
 - d. Licensees would choose to have their advisers' conduct against the standards monitored by a professional association with oversight by the independent monitor or directly by the independent monitor.
 - e. A co-regulatory relationship would exist between professional associations and the independent monitor in relation to code compliance.
10. The advantages the revised model will deliver include:
- a. greater clarity, clearer access and a single point of contact for consumers if concerned about adviser compliance with the code's standards
 - b. all advisers are subject to consistent oversight and application of the standards across the sector

- c. greater consistency, transparency and independence of monitoring and enforcement across the sector
- d. avoiding unnecessary duplication and confusion with multiple tiers of accountability for advisers who are members of more than one professional association and with different monitoring and enforcement frameworks within licensees
- e. one single, transparent and independent monitoring and reporting function to assist the standards setter to continuously improve the standards and competency frameworks set and
- f. reduced costs associated with the establishment of a single code monitor.

1 Introduction

FOS is approved by ASIC to operate as an independent external dispute resolution scheme in the financial services sector.⁵ We also provide code compliance and monitoring services for four industry codes of practice. Appendix 2 provides information about our role in relation to code compliance and monitoring.

This submission recommends minor modification to the reforms provided for in the Bill, which we think enhance the government's ability to achieve its stated outcomes and objectives. If we can provide further input or assistance, please do not hesitate to contact us.

2 Objectives of reforms

We support the initiatives to raise the professional, ethical and education standards of financial advisers. These initiatives include developing a comprehensive single code of ethics for all financial advisers.

As set out in the explanatory material for the Bill, the aim of the provisions for the proposed Code of Ethics is that *"all relevant providers providing advice on all relevant products will be covered by and subject to the same Code and ethical standards"*.⁶

3 Key design principles

To ensure the reform model increases trust and confidence in the advisory sector, and improves the quality of advice, we believe that the consumer needs to be at the centre of its design. Key design principles to achieve this include:

⁵ FOS is approved by ASIC under its Regulatory Guide 139 *Approval and oversight of external dispute resolution schemes* available on www.asic.gov.au under "Regulatory Resources".

⁶ See Exposure Draft Explanatory Material for the Bill, page 14.

- **Simplicity** – of the model and the code’s standards, so that it is clear and easy for all stakeholders to understand and comply.
- **Accessibility** – for consumers, who should be represented at all governance levels within the model and who should have clear and simple access to redress if an adviser does not comply with the standards.
- **Independence** – of the standards setting body and of the code monitor responsible for oversight of compliance with and enforcement of the ethical standards.
- **Transparency** – of performance and reporting about compliance with the standards and accountability arrangements.
- **Accountability** –of all advisers against a single and universally applied set of standards, with a shared and clear understanding of who is responsible for non-compliance.
- **Consistency** – consistent and transparent application of the competency, continuing professional development and ethical standards set by the standards setting body across the sector. .

4 Key design features

To meet the stated objectives of the reforms, we suggest that the reform model outlined in the Bill be slightly modified as follows:

- One standards setting body remains (Standards Body).
- It sets the single Code of Ethics (Code), as well as other standards for the advisory sector.
- To ensure the Bill’s objective that the same ethical standards consistently apply across the sector, the Standards Body establishes or appoints one independent monitor (Independent Monitor) to monitor the performance of all advisory participants against the Code’s standards.
- That Independent Monitor will also audit and report on that performance to inform continuous improvement in the standards set by the Standards Body.
- The governance and operations of the Independent Monitor should be modelled on the existing guidance for such bodies outlined in ASIC’s Regulatory Guide 183. This model is well established and accepted for other finance sector industry codes.
- Professional associations continue to have an important role to play in influencing the ethical and professional conduct and behaviour of individual

advisers, whilst Australian Financial Services Licensees (Licensees) retain final responsibility and accountability for the advice provided to consumers.

- To recognise these roles, a two tiered monitoring framework could still be adopted, utilising the proposed 'compliance scheme' model in the Bill:
 - Tier 1 scheme - Professional associations would have a co-regulatory relationship with the Independent Monitor. They would remain responsible for monitoring the performance of their members against the Code's standards, subject to the oversight of, and to annual reporting requirements to, the Independent Monitor.
 - Tier 2 scheme – all AFS Licensees or groups of licensees who chose to have the performance of their advisers against the Code's standards separately monitored instead of supporting association membership, may do so by engaging the Independent Monitor to undertake this service.
- The changes would also be consistent with a single tier model where the code obligations operate through membership of a professional association. We continue to support the important role professional associations play in influencing the ethical and professional conduct and behaviour of their members and individual advisers.
- The obligation for the licensee or professional association to have its scheme approved by ASIC remains in accordance with the current provisions of the Bill.
- One levy would be imposed annually on AFS Licensees to cover the code monitoring services provided by the Independent Monitor. The levy would be based on user pay principles.
- The fees payable by AFS Licensees for Tier 1 monitoring could be charged at a reduced rate to recognise the role played by professional associations in front line monitoring of the Code for their members reducing the operating and monitoring costs of the Independent Monitor for this tier.
- This levy could be established as part of any new levy for funding ASIC's regulatory function to simplify and reduce costs for participants if established. On an interim basis separate fee arrangements could be established for the purposes of funding the new standards and monitoring regime.
- ASIC's Regulatory Guide 183 states that, if a code monitor is not independent and adequately resourced, there is a risk that oversight of compliance with a Code will be reduced, systemic problems will not be identified and industry

and consumer awareness of the Code and its standards will be low.⁷ These are all risks that will be avoided if one Independent Monitor is established

5 Key differences between the models

The key differences between the models are that, under the revised model we recommend:

- Clear governance standards for the code monitor are set out.
- There is one independent code monitor, not many.
- The code monitor is established by, or a sub-committee of, the standards setting body.
- AFS Licensees would choose to have their advisers' conduct against the standards monitored by a professional association with oversight by the Independent Monitor or, if a two tiered model is adopted, directly by the Independent Monitor.
- A co-regulatory relationship would exist between professional associations and the Independent Monitor in relation to code compliance.

The outcome is that compliance with the Code across the whole sector is subject to consistent and universal oversight.

6 Benefits of features recommended

We suggest there are a number of benefits associated with our proposed modification to the reform model in the Bill. These benefits include:

- It builds on and supplements current elements of the regulatory framework.
- It provides greater clarity, clear access and a single point of contact for consumers, rather than a myriad of different bodies that may or may not be responsible for the compliance of a particular adviser with the standards.
- It provides greater ability to identify and address individual and aggregated trends in compliance, gaps in standards or need to modify or enhance the new standards setting framework.
- In doing so, it creates one feedback loop to continuously improve standards rather than many.
- It reduces the real risk that the standards will be applied and interpreted inconsistently across the sector.

⁷ See paragraphs 76 to 79 of Regulatory Guide 183.

- It reduces the risk, confusion and duplication associated with a myriad of different code monitoring and enforcement models within the sector.
- It increases the transparency and independence of the framework.
- It ensures joint consumer and industry participation in the monitoring of the standards as well as in the setting of the standards.
- It avoids inconsistency and duplication in accountability for those many advisers who are members of more than one professional association (by choice) and different monitoring and enforcement frameworks imposed by AFS Licensees.
- We anticipate that the estimated cost impact may be reduced, by conferring oversight responsibility for all monitoring on the Independent Monitor.
- It reduces reliance on AFS Licensees to self-regulate their compliance against the ethical standards, thus reducing potential or perceived conflicts of interest. (The current model in the Bill relies on AFS Licensees discharging obligations for reporting and self-regulation.) Recent evidence suggests that:
 - AFS Licensees do not meet all of their reporting obligations and some licensees even fail to report breaches of the Corporations Act, and
 - ethical leadership and culture within some AFS Licensees may currently not be at a sufficient level to ensure effective self-regulation, even through the appointment of their own code monitor.

7 Consumer rights

To avoid confusion and ensure consumer protection is a paramount feature of the model, we envisage that any rights held by consumers to seek redress for financial loss arising from alleged breaches of the Code would be handled by existing ASIC-approved external dispute resolution (EDR) schemes.

Referral arrangements could be established between EDR schemes and the Independent Monitor to facilitate proper handling of consumer complaints. The Code of Banking Practice could be used as a model for these arrangements.⁸

8 Resources and expertise of code monitor

There are different models that could be used when designing the Independent Monitor. The code monitor could operate as an entity with its own secretariat and compliance staff or, alternatively, it could be based on current arrangements for monitoring of financial sector codes where the various code monitoring committees

⁸ See clause 6 of the [Code Compliance Monitoring Committee Mandate](#).

have outsourced secretariat and compliance functions to FOS as the code administrator. We consider the latter model is well understood and accepted in the industry with clear efficiency and consumer benefits.⁹

The Independent Monitor will need to draw on expertise and experience in administration, secretariat, monitoring and enforcement of industry codes of practice. FOS has such expertise and experience and has developed and refined code monitoring systems within the financial services sector.

FOS is well positioned to support the Independent Monitor and should be able to provide support more economically than other organisations.

9 Further detail about the proposed governance structure

In our view, the Independent Monitor should:

- be an independent body appointed by the Standards Body, or a sub-committee of that body
- be structured consistent with the governance and operational requirements for code monitors outlined in ASIC's Regulatory Guide 183
- have a board with an independent chair and equal numbers of consumer and industry directors
- have code monitoring oversight across the whole sector, to ensure the Code's standards are interpreted and applied consistently across the advisory sector
- oversee the monitoring of member performance against the Code's standards undertaken by professional associations under the Tier 1 code compliance scheme
- conduct monitoring and enforcement activities for AFS Licensees that choose the Tier 2 code compliance scheme and
- report on its functions and operations to the Standards Body, ASIC and publicly.

10 Further detail about the tiered compliance scheme

If a two tiered model is adopted, we suggest that a slightly modified version of the proposed 'compliance scheme'" model in the Bill could still apply:

⁹ See Appendix 2 for further information about our experience in monitoring code compliance.

- Tier 1 – co-regulatory with professional or industry associations which report on the performance of their individual adviser members annually to the Independent Monitor against the Code’s standards.

AFS Licensees who choose the Tier 1 scheme for their advisers would pay a fee based on the reduced level of compliance risk that would be inherent in this model.

- Tier 2 – all other AFS Licensees or groups of AFS Licensees - who choose to have the performance of their advisers against the Code’s standards separately monitored, instead of supporting association membership, would be monitored by the Independent Monitor.

Licensees who choose the Tier 2 scheme would be charged a fee commensurate with the compliance risk associated with this tier and operational requirements of the Independent Monitor, to ensure adequate monitoring of code compliance was undertaken.

The changes would also be consistent with a single tier model where the code obligations operate through membership of a professional association. We continue to support the important role professional associations play in influencing the ethical and professional conduct and behaviour of their members and individual advisers. In this case the obligations set out for Tier 1 would apply.

Under our model, ASIC would retain oversight of the code monitoring framework and approve compliance schemes within the two-tier structure. AFS Licensees and advisers would also continue to have annual reporting obligations to ASIC as proposed in the Bill, in relation to their compliance with continuing professional development obligations and code breach activity. Reporting to ASIC in connection with the financial advisers register would not be affected.

AFS Licensees should also be required to report any identified non-compliance of the Code’s standards to the Independent Monitor for enforcement and reporting action.

Appendix 1- About FOS

FOS was formed in 2008 from the merger of three predecessor schemes organised largely along industry sector lines. The original participants were:

- the Banking and Financial Services Ombudsman
- the Financial Industry Complaints Service, and
- the Insurance Ombudsman Service.

On 1 January 2009, two other schemes joined FOS, namely:

- the Credit Union Dispute Resolution Centre, and
- Insurance Brokers Disputes Ltd.

FOS is an ASIC-approved independent EDR scheme that covers disputes across the financial sector. Our service is free to consumers and is funded through a combination of levies and case fees paid by our members, which are financial services providers.

Our operations are governed by our Terms of Reference that form a contract with our members. The Terms of Reference are available on our website.

FOS and its predecessor schemes have over 20 years' experience in providing dispute resolution services in the financial services sector. FOS provides services to resolve disputes between member financial services providers and consumers, including certain small businesses, about financial services such as:

- banking
- credit
- loans
- general insurance
- life insurance
- financial planning
- investments
- stock broking
- managed funds, and
- pooled superannuation trusts.

As well as its functions in relation to dispute resolution, FOS has responsibilities to identify and resolve systemic issues and obligations to make certain reports to ASIC.

FOS also provides code monitoring, administration and secretariat services to four Code Compliance Committees who monitor financial services providers' compliance with industry codes of practice. Appendix 2 provides more detail about our code compliance and monitoring services.

FOS is governed by a board with an independent chair and:

- four 'industry directors' appointed based on their expertise in and knowledge of the financial services industry, independence and capacity and willingness to consult with the industry, and
- four 'consumer directors' appointed based on their expertise in consumer affairs, knowledge of issues pertaining to the industry, independence and capacity and willingness to consult with consumer organisations.

Appendix 2 – Industry codes of practice

Codes of practice set standards of good industry practice for financial service providers to follow when dealing with people who are, or who may become, individual or business customers. A separate business unit of FOS supports the work of independent committees¹⁰ responsible for monitoring compliance with these codes:

- the Code of Banking Practice
- the Customer Owned Banking Code of Practice
- the General Insurance Code of Practice, and
- the Insurance Broker's Code of Practice.

The committees comprise an independent chair, a consumer representative and an industry representative. In our experience this composition facilitates transparency and accountability in the code monitoring and governance frameworks.

Each of the contractual arrangements with the committees is the subject of a separate funding and service level agreement with the relevant industry body or code committee.

Each code subscriber has made a commitment to:

- work to improve the standards of practice and service in their industry
- promote informed decisions about their services, and
- act fairly and reasonably in delivering those services.

¹⁰ See pages 101 to 104 in [FOS Annual Review 2014-2015](#) for further information about this work.