

The Hon Kenneth Hayne AC QC
Commissioner
Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

07 December 2018

By email: FSRCenquiries@royalcommission.gov.au

Dear Commissioner,

The Professional Standards Councils (Councils)¹ refers to our 5 June 2018 submission to the Royal Commission into Professional Misconduct in the Banking, Superannuation and Financial Services Industry.

We believe that properly supervised, occupational associations can play an important role in improving conduct and behaviour in the banking, superannuation and financial services industry. What follows are some high-level ideas about how the Councils could use their legislative mandate and regulatory experience to help occupational associations achieve levels of professionalism that will see the individual members of the associations focus on their obligations to customers as paramount to their obligations to their employer firms. If these ideas are of interest to the Commission, we would be happy to elaborate on this material.

Our interest with the Commission is particularly focussed on the work of the Commission relating to the governance and culture of the industry.² We respectfully suggest that the Councils can help various associations that represent individuals in the industry to develop strong professional standards that complement other elements of a strong regulatory and supervisory framework. If effectively established and monitored we believe that such systems can ensure that all Australian consumers, including business, have confidence and trust in the financial system.

¹ The Councils are empowered to encourage, advise and assist in the development of self-regulation of occupational associations in respect of the following professional standards:

- (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 and;
- (ix) Continuing occupational education.

The Councils have specific responsibilities under professional standards legislation for assessing and approving applications for, and supervising the operation of, Professional Standards Schemes. The powers of the Councils are discrete and are prescribed in professional standards legislation. The Councils also play a key role in improving professional standards and protecting consumers by monitoring how well associations and their members meet the standards demanded by their Professional Standards Schemes; providing Ministers with advice regarding the professional standards of members of professional associations, including the operation of Professional Standards Schemes; encouraging and promoting the self-regulation of professional associations; overseeing the strategy for research and education in professional standards and regulation; and determining future projects to raise the capacity of occupational associations to improve professional standards.

² Royal Commission into Professional Misconduct in the Banking, Superannuation and Financial Services Industry, 12 February 2018, 11.

To the extent that the industry accepts that it needs to turn from a focus on the interests of the industry members to the interests of their customers, the Councils believe that they can assist associations in the industry undertake self-regulatory capacity-building, with a primary focus on the protection of their members' customers.

We believe that professional conduct is not the exclusive domain of the established "professions."³ Professional conduct is open to all occupations that uphold and improve occupational standards that aim to protect their consumers. It is this element of our approach that we would commend to the Commission.

It seems to us that one of the themes for the Commission is how to guide the financial services sector to build and maintain a culture that sees the paramount duty of the individuals in the industry as being to their customers. Something that has been seen to be lacking in many of the scenarios presented by the Commission.

We do not presume to know but we would expect that the environment of regulatory enhancements that the Commission might recommend are both command regulation and self-regulation. These two streams can operate side by side to provide better regulatory outcomes for the public than either strategy in isolation, including through a combination of deterrent and cooperative enforcement strategies.⁴ However, we believe that self-regulation is most effective where it includes a command structure that drives the regulated professionals to apply and enforce their self-regulatory codes. Indeed, even within that model there can be multiple limbs. For example, we do not see the enhanced role for accredited associations that we propose to be inconsistent with requiring industry participants to have enforceable codes of conduct including with respect to matters like whistleblowing.

The Councils consider that to be effective self-regulation must be done by associations that regulate individuals and hold their members to the highest standards. This would seem consistent with the narrative of modern criminologists that has debunked character, greed and values as the main drivers of deviant behaviour. Instead the theory with most traction for explaining prevalence is techniques of neutralisation i.e. people know what they ought to do but don't because within a sub-group it is rationalised as acceptable if not accepted by society as a whole, which is deemed not to understand the dynamics of business.⁵

We agree that the financial adviser code monitoring associations have limited history, capacity, resources and experience to operate as the first-line self-regulators of a professional standards initiative. However, we believe with the right help they and others like them could build the capacity to self-regulate the conduct of their members and to help manage a transition to an industrywide cultural norm that demands respect for the customer.

Associations can be helped to transition from being exclusively focused on the industry they represent to one focused on their members' conduct and the customers of the banking, superannuation and financial services industry.

The Councils submit that mandatory membership by individuals of associations with effective codes of ethics and supporting codes of practice are an important part of improving conduct and behaviour by the people in the industry. As recognised in the Interim Report, codes of

³ Councils codes of ethics guidance holds that traditional conception of a profession is an occupation with the following five features:

- (i) the work of its members is oriented to the provision of some good;
- (ii) members of the group possess and exercise creative expertise in the provision of this good;
- (iii) they possess a high degree of autonomy in the exercise of their expertise;
- (iv) they are grouped together as a self-conscious community; and,
- (v) they have a certain institutional status which typically is accorded legal recognition and protection.

Councils Code Guidance, 10. Details of our legislative model are set out in some detail in Appendix A.

⁴ Enforcement that is responsive (that is, includes working with the vast majority of the willing and the able) generates voluntary commitment to compliance and compliant behaviour in the future J Braithwaite Restorative Justice and Responsive Regulation, 2002

⁵ Justin O'Brien LinkedIn post <https://www.linkedin.com/feed/update/urn:li:activity:6472740314594574336>

ethics are not laws but are important to fostering practitioner integrity in a profession, protecting the public from misconduct and complementing the objectives of command regulation and enforcement.

We support the Commonwealth Treasury submission in suggesting that:

Effective leadership, good governance and an appropriate culture within financial firms and the industry is key to ensuring good outcomes for consumers. Good systems, improved cultural norms and a more professional ethos within firms and the industry can reduce the need for prescriptive regulation that imposes significant regulatory costs. They can drive a more timely alignment between community expectations and changing customer needs than is achievable by slow moving regulations. Where good governance and culture is established, those regulations that are required can be more effective. While regulatory levers to effect such a change are limited, well-targeted regulation and effective regulators play an important supporting role, and the Commission itself should act as a catalyst for change.⁶

The Councils submit that to be effective these codes must be correctly conceived at the outset and remain responsive to community standards and expectations over time. This leads to a requirement for guidance and oversight of a code and an obligation on the associations and their membership for continuous improvement.

While the Interim Report has identified the failings of some codes, the Councils submit that these codes, no matter how embellished, were not originally designed to meet the standards that we have described. That is, to demand the highest levels of conduct by the individual association members in their interactions with their customers. Nor were they subject to effective external oversight designed not only to see that the codes are enforced but also to assist the association in developing the knowledge and understanding of its members that will embed the principles of the code in the members' own conduct. Further, codes have not been given a chance to operate as they should, as they often sail against a tide of corporate culture informed by contrary incentives.

These factors might also apply to considering any advances in the use of individual accountability mechanisms in a corporate context such as in respect of the Commonwealth Treasury suggestion to extend the application of the recently introduced Banking Executive Accountability Regime (BEAR) to other financial services entities, as well as the scope of conduct to which the BEAR applies.⁷

From a regulatory policy perspective, the Councils position is consistent with the Commonwealth Treasury in respect of balancing the need for law and codes.⁸

The Councils submit that a proactive regulatory framework that focuses on setting and maintaining professional standards is one way to effectively identify, regulate and address professional misconduct in the banking, superannuation and financial services industry, to

⁶ Commonwealth Treasury, Financial Services Royal Commission - submission on key policy issues, 13 July 2018, para 10.

⁷ Commonwealth Treasury, Financial Services Royal Commission – submission Interim Report, para 14.

⁸ Treasury submission, 13 July 2018, para 50 says:

In considering possible responses to the misconduct and corporate governance failings observed, we start from the premise that regulatory intervention by the government is best considered only after it has been determined that a market based option, or self-regulation, would not be effective. Self-regulation, in the case of companies, may be through effective empowerment of shareholders or through more independent and effective board members. The degree to which people in financial services consider themselves professionals, and change their conduct accordingly, also affects the extent to which additional regulatory intervention is required. There is also the option of co-regulation through industry bodies or codes.

meet changing community standards and expectations, and to provide appropriate redress to consumers. Appendix A provides an overview of the professional standards framework and its ability to identify, regulate and address professional misconduct.

The Councils submit that there are numerous benefits that arise from the professional standards framework.

First, the professional standards framework provides increased consumer protection through the requirement that associations enforce high standards of practice by their members through overt recognition of the duty to put customers' interests ahead of their own or their employer, continuing professional development and risk management requirements.

Second, the focus of the professional standards framework is not upon punishment and supervision but rather on embedding and sustaining improvements in professional standards and holding members of the occupational associations against them. The professional standards framework encourages associations and their members to implement a range of measures to improve professional standards and practices – from effective risk management strategies and continuing professional development programs, to codes of ethics and conduct and integrity systems.

Third, the professional standards framework enables the collation of data on professionalism. Indeed, it is the only area in which such comprehensive data is collected, retained and utilised in Australia. Associations are required to report on their actions, policies and decisions in relation to their continuing professional development programs; their complaints handling and disciplinary systems; their risk management reporting framework; their insurance cover, claims and business assets monitoring and their annual audit of their members.

The report on complaints handling and disciplinary systems requires associations to collect data on the total number of complaints received, including dismissed complaints; the nature and type of complaints; the causes of complaints; the number of complaints resolved without disciplinary action; the number of complaints resulting in disciplinary action and the average length of time taken to resolve complaints. Most importantly, associations are required to analyse the data for trends and determine methods to improve future practice and provide that analysis to the Councils.⁹ Because of the requirement to provide annual reports, the Councils have a wealth of information regarding the professionalism of associations' members.

The Councils respectfully submit that the professional standards framework is an appropriate regulatory approach to reduce the likelihood of professional misconduct by individuals providing banking, superannuation and financial services within entities in the future. Properly supervised the problem of self-regulatory failure can be overcome through appropriate standards, adequate monitoring, and adequate strength.¹⁰ The professional standards framework has operated efficiently and successfully for over two decades on the basis of co-operation between Commonwealth, State and Territory governments, using harmonised legislation to facilitate national coverage and co-ordination of responsibilities across the different levels of government. The professional standards framework enables the collation of comprehensive data regarding the conduct of industry participants. In the Councils' experience this data is essential in identifying and correcting behaviour which fails to meet community expectations and in the early identification of where the industry is moving away from community expectations.

The Councils submit that an effective response to ensuring that professional misconduct is abated by implementing a regulatory framework that focuses on embedding and improving

⁹ The requirement to provide annual reports is like the model implemented by AUSTRAC which also requires entities to self-report.

¹⁰ Roy F. Baumeister & Todd F. Heatherton (1996) Self-Regulation Failure: An Overview, *Psychological Inquiry*, 7:1, 1-15

professional and ethical conduct with the individual industry member being required to overtly recognise his or her paramount obligation to the customer.

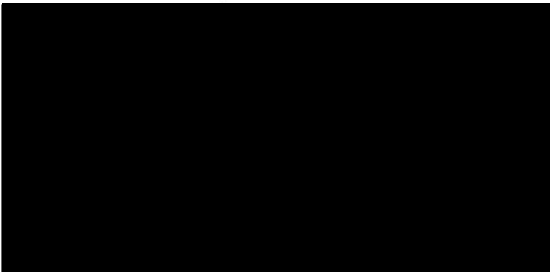
The Councils therefore suggest to the Commission that:

1. all significant participants (including board members and beyond BEAR) in the banking, superannuation and financial service industry be required to be members of an accredited association;
2. the professional standards framework be modified and expanded to establish a model to accredit such associations requiring a paramount duty to individual consumers; and
3. the professional standards framework be modified to require the collection of data to monitor and report on the levels of alleged and actual misconduct by individuals in the industry.

The professional standards framework can be likened to an agreement between the associations that regulate industry members and the community - a social compact - which requires the professions to actively pursue strategies that will improve standards and that make professionals more accountable to the community. It is an effective and appropriate framework to foster ethical conduct and ensure Australians are treated honestly and fairly in their dealings with their banking, superannuation and financial service providers.

We commend the professional standards framework to the Commission as a potentially powerful part of the regulatory architecture needed to respond to the conduct and culture identified and criticised in the Interim Report.

Yours faithfully



Annexure A

Background

The Professional Standards Framework

Professional standards legislation permits an occupational association to apply for and operate a scheme under which specified (corporate or individual) members' occupational liability is limited, to a defined extent.

To maintain a Professional Standards Scheme, associations must participate in ongoing compliance and professional standards improvement programs and submit detailed annual reports on their programs. Occupational associations are required to ensure that members comply with requirements of the schemes once approved.

The persons to whom a scheme applies is clearly defined in professional standards legislation. Section 17(1) of the *Professional Standards Act 1994 (NSW)*, for example, states:

"A Scheme may provide that it applies to all persons within an occupational association or to a specified class or specified classes of persons within an occupational association."

The legislation provides that a scheme may also apply to other persons including officers of body corporates, to which, as well as partners, employees or prescribed associates of persons to whom, a scheme applies.¹¹

An "occupational association" is defined in professional standards legislation as a body corporate "which represents the interests of persons who are members of the same occupational group" and "the membership of which is limited principally to members of that occupational group."¹² An occupational group is defined to include a "professional group and a trade group."¹³

Since its inception a growing number of associations and their members have chosen to operate a professional standards scheme. Presently there are 17 Australian peak associations that operate a Professional Standards Scheme. These associations collectively cover more than 73,000 professionals in diverse fields. At present the Institute of Public Accountants, the Institute of Chartered Accountants and CPA Australia are the only bodies that operate across aspects of financial services that are regulated through the Professional Standards Scheme.

To maintain a Professional Standards Scheme, associations must maintain an ongoing Professional Standards Improvement Program (**PSIP**). The PSIP comprises of a range of policies and programs that improve professional standards and ensure consumer protection.

The PSIP includes, for example: a code of conduct, code of ethics, complaints processes, continuing professional development programmes etc. Associations should, for example, have continuing professional development programs in place to address any identified trends, knowledge gaps or consumer risks in your industry; continually improve your members' professional standards and practices; and make sure their members continue to

¹¹ If a Scheme applies to a body corporate, the Scheme also applies to each officer of the body corporate and if the Scheme applies to a person, the Scheme also applies to each partner of a person, and if the Scheme applies to a person, the Scheme also applies to each employee of that person, provided that if such officer of the corporation or partner of the person or employee of the person is entitled to be a member of the same occupational association, such officer, partner or employee is a member of the occupational association. Section 22 provides that the Scheme also applies to other persons prescribed by the regulations for the purposes of s 31(4) as being associated with persons to whom a scheme applies.

¹² In 2004, the NSW Government passed the *Professional Standards Amendment Act 2004* (which amongst other things) extended the definition of occupational association to include associations that comprise members of more than one related occupational group. Western Australia passed similar legislation.

¹³ Interestingly, "professional group" and "trade group" are not defined in the professional standards legislation. The definition is however expressed to be inclusive rather than exclusive.

meet high professional standards. Associations should establish and monitor consumer complaint channels and discipline systems.

Associations with schemes are required to submit detailed annual reports on this program to the Councils. The Councils review these annual reports to make sure associations are meeting their obligations under the legislation.

If an association doesn't meet its legislative requirements, the Councils can issue warnings, seek fines through the courts, or consider revoking the association's Professional Standards Scheme.

The Councils assume the role of a meta-regulator within the professional standards framework. As a meta-regulator the Councils have a long-term objective to raise the capacity of occupational associations to improve professional standards and to self-regulate effectively. Pursuant to this objective, the Councils can advise occupational associations to assist them develop self-regulatory systems and to improve their professional standards by implementing risk management strategies and professional integrity systems.

The Councils conduct research, develop policies and guidelines, and organise events to promote debate and change in the areas of professional standards, codes of ethics and conduct, and risk management, to protect consumers.

Capacity Building – professional standards grants.

The Councils have successfully administered a grants program which can assist occupational associations with the development of their professional standards systems to protect consumers.

The Councils offer two types of grant programs - professional standards grants and research grants. To date the Councils have funded 10 professional standards grants and two research grants that amount to more than \$1 million. Professional Standards Grant recipients have, for example, included The Victorian Bar, the Institute of Public Accountants, the Queensland Law Society, the Professional Surveyors Occupational Association and the Institute of Chartered Accountants (now Chartered Accountants Australia New Zealand).

The Adequacy of Industry Self-Regulation

The Councils submit that the current form of industry self-regulation to identify, regulate and address professional misconduct, to meet community standards and expectations and to provide appropriate redress to consumers is inadequate by itself and generally unsupported in the regulatory framework, with the notable exceptions of the professional standards legislation, now in existence for 24 years, and the evolving code-approval powers of ASIC.

For industry-based self-regulation to be effective, it must augment empowered and supportive command regulation. To achieve this goal, data supporting professionalism must be collected and analysed at the national level, with an object of protecting the consumer.

The Councils submit that the inability of industry self-regulators to identify, regulate and address professional misconduct is compounded by no centralised national data collection on professional conduct in the industry. The Australian Bureau of Statistics collects and publishes limited data by industry however the data is not granular and provides no assistance to identify professional misconduct or any kinds of trends in the industry.

The nearest limited proxy is the National Claims and Policy database of APRA. Similarly, the Councils submit that the limited nature of the data prevents a true understanding of the extent and nature of the *professional* misconduct. The Councils submit that if professional misconduct cannot be measured, then it cannot possibly be said to be regulated or managed, nor reveal the standards of behaviour or conduct that are expected by consumers. This is currently not done and accordingly the national data and evidence to support these regulatory outcomes is not available. The ABS and ANZSOG could be recalibrated to collect and analyse professionalism data, not occupational data.

Necessarily a framework of laws made by the legislature, while circumscribing minimum conduct and the punishment for non-compliance, is always reactive and necessarily slow to accommodate the increasing standards of the community. Law has been found to be ineffective at increasing standards of professional conduct and more importantly, can oddly encourage unprofessional conduct.¹⁴

Moreover, the focus on punishment as deterrence effectively creates a disincentive for reporting or acting on professional misconduct.

The Councils submit that encouraging further command regulation, and accordingly, further incentives for avoidance, and fewer incentives for better or best behaviour, risks not meeting the community expectations of an open, honest and ethical financial sector. Similarly, it is arguable that an increased focus on public enforcement alone does not build sustainable change or satisfy the wronged consumer. Of itself and without the support of a professional regulatory strategy, a framework of laws will not increase the professional standards of individuals within the banking, superannuation and financial services industry and therefore cannot protect consumers or ensure that all Australians are treated honestly and fairly in their dealings with banking, superannuation and financial service providers.

The Councils submit that a proactive regulatory framework is key to building sustainable change. This is because a proactive regulatory framework enables regulators to develop processes and procedures designed to deal with conduct and behaviours before they become a problem and ensures that appropriate data is collected and assessed to recognise emerging problems for preventative action. The Councils submit that a regulatory framework that focuses on setting and maintaining professional standards such as the professional standards model is central to reform that will effectively identify, regulate and address professional misconduct in the banking, superannuation and financial services industry, to meet community standards and expectations and to provide appropriate redress to consumers.

The current regulatory framework does not focus on professional misconduct. The identification and regulation of professional misconduct, with an object of protecting individual consumers, is not a stated regulatory objective or strategic priority, and has not been thoroughly addressed in recent times. Professional conduct is shoehorned into a system of laws designed to regulate the conduct of corporate entities with an objective of protecting the market or the economic system, and sometimes the entities themselves.

Professional conduct must not be conflated with organisational culture because the public expectations of professional conduct are not attenuated or modified by corporate culture. However, for longevity in corporate value, corporate culture and professional conduct must accommodate the evolving public interest and customer expectations.

The Council's submission to compliment the regulatory framework in the banking, superannuation and financial services industry which is focused on command and control with a focus on embedding and sustaining high professional standards through the professional standards framework has already received some industry support beyond those associations already operating approved schemes.

The Financial Planning Association of Australia (FPA), for example, has voiced their support for the professional standards framework. In their submission to the Parliamentary Joint Committee on Corporations and Financial Services inquiry into proposals to lift the professional, ethical and education standards in the financial services industry, the FPA submitted that the professional standards framework is "a successful cooperative federal

¹⁴ L. Hail, A. Tahoun and C. Wang, Corporate Scandals and Regulation (October 15, 2017). European Corporate Governance Institute (ECGI) – Law Working Paper No. 367/2017, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2961535

and state government initiative for the public regulation of professions through individual professional membership.”¹⁵

The Association of Financial Advisers (**AFA**) voiced similar support for the professional standards framework as an appropriate body and process to recognise professional associations and thereby lift the professional, ethical and education standards in the financial services industry.¹⁶

The Parliamentary Joint Committee on Corporations and Financial stated that:

The committee considers that requiring professional associations to establish Professional Standards Schemes approved by the Professional Services Councils has a number of advantages including that:

- the PSC is an existing body, so no new body would be created;
- Professional Standards Schemes are an established process that has been implemented in other sectors; and
- three industry associations whose members provide financial advice are already covered by Professional Standards Schemes.¹⁷

The Parliamentary Joint Committee additionally considered that requiring professional associations to establish Professional Standards Schemes approved by the Councils has several advantages. These advantages were cited by the Parliamentary Joint Committee to include as follows:

- the Councils are an existing body, so no new body needs to be created;
- Professional Standards Schemes are an established process that has been implemented in other sectors; and
- three industry associations whose members provide financial advice are already covered by Professional Standards Schemes.¹⁸

The Parliamentary Joint Committee in its support of the professional standards framework recommended as follows:

financial sector professional associations that wish to have representation on the Finance Professionals' Education Council and to be able to make recommendations to ASIC regarding the registration of financial advisers, should be required to establish Professional Standards Schemes under the Professional Standards Councils, within three years.¹⁹

The Government however did not agree to the recommendation citing that “substantial legal impediments” exist to the use of the professional standards framework within the Commonwealth arena.²⁰

The “legal impediments” referred to by the Government, such as limitation of liability, can be addressed by modifications to the professional standards legislative framework to extend the scheme framework from a State-based model to a Commonwealth model, and by modifications to enable limitation schemes and accreditation schemes.

¹⁵ Financial Planning Association of Australia, *Submission 6 to the Parliamentary Joint Committee on Corporations and Financial Services inquiry into proposals to lift the professional, ethical and education standards in the financial services industry, supplementary submission*.

¹⁶ Association of Financial Advisers, *Answers to questions on notice*, taken on 14 October 2014, (received on 3 November 2014).

¹⁷ Parliamentary Joint Committee on Corporations and Financial Services Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry, December 2014, 70.

¹⁸ *Ibid.*

¹⁹ *Id* at xvi.

²⁰ Recommendation 12. Australian Government response to the Parliamentary Joint Committee on Corporations and Financial Services report: Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry, August 2017.

The Councils have identified and developed amendments to address the modifications and thereby ensure consistency and harmonisation between the States and the Commonwealth, and the ability of emerging professions or occupations to obtain a scheme with comprehensive statutory supervision of the operation of schemes by Councils.