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31 March 2014

Submitted via email to fsi@fsi.gov.au

Dear Panel members,

CFA Societies Australia's Submission to the Financial System Inquiry

On behalf of our members, CFA Societies Australia welcomes the opportunity to participate in the consultation process for the Government's Financial System Inquiry ("the Inquiry"). As a member-based non-partisan organisation, the CFA Institute has a long history in providing educational services to the financial industry. Globally it is recognised as having an active voice in advocating for reforms to improve the functioning of the financial system.

In the following submission we provide comments on specific areas where we believe the CFA Institute can offer advice. In making this submission, the CFA Societies Australia have drawn on the resources of the CFA Institute, which dedicates significant resources to researching issues of national and international relevance to the finance sector. A further point of note is that the CFA Institute is member-based with representation across all sectors of the finance industry, so has no special interests. Finally, one of the key requirements of CFA members is to uphold the highest ethical standards, an area which forms a core part of the CFA qualification and which must be reaffirmed on an annual basis.

A key ongoing initiative of the CFA Institute which is directly relevant to the Financial System Inquiry is the "Future of Finance". This initiative involves six primary topics of interest: putting investors first; safeguarding the system; retirement security; financial knowledge; regulation and enforcement; and transparency and fairness. The initiative plans rigorous research and recommendations to address each area, and will produce accessible tools to encourage broad adoption and widespread change throughout the global financial system. Comments in the accompanying submission draw on this work.

Global thought leaders in the international financial system are involved in a number of CFA Institute's efforts such as the Future of Finance initiative and the Systemic Risk Council. Among many individuals these leaders include Paul Volcker, Mary Schapiro, Robert J. Shiller, Sheila Bair, Andrew Sheng, Jeremy Grantham, Keith Ambachtsheer and Andrew W. Lo.

This submission is structured into the following sections:

1. Executive Summary addressing Terms of Reference items
2. Addressing the Terms of Reference in Detail
3. Short Background to the CFA Institute
4. About the CFA Institute Future of Finance Initiative
5. Australian CFA Membership Survey, February 2014

Should the Inquiry wish to discuss any aspects of this submission the CFA Societies Australia would be very pleased to respond to any questions or to arrange a meeting with relevant local members and/or CFA Institute staff. Please direct all enquires to Angela Pica, Head of Advocacy, CFA Societies Australia and New Zealand at advocacy@cfas.org.au.

Yours sincerely,

Richard Brandweiner, CFA President CFA Society Sydney	Paula Allen, CFA President CFA Society Melbourne	Jason G. Chesters, CFA President CFA Society Perth

1. Executive Summary addressing Terms of Reference items:

Item 1.3. The current cost, quality, safety and availability of financial services, products and capital for users.

CFA Societies Australia believes that improvements can be made in this area by wider adoption in Australia of consistent standards established globally by the CFA Institute. These include: the Code of Ethics and Standards of Practice; the Asset Manager Code of Conduct; and the Global Investment Performance Standards.

Item 2.1. Balancing competition, innovation, efficiency, stability and consumer protection

We believe that investor interests can be put first by a focus on fiduciary duty aided by better training of financial advisors, making use of a Statement of Investor Rights and restricting sales inducements. CFA Societies of Australia and CFA Institute have undertaken research and made submissions in these areas.

Item 2.2. How financial risk is allocated and systemic risk is managed;

As a global profession, CFA Institute and CFA societies worldwide are concerned about how systemic risk is managed. Insights can be gained from findings of the Systemic Risk Council (SRC) which was formed by CFA Institute and The Pew Charitable Trusts to monitor and encourage regulatory reform of U.S. capital markets focused on systemic risk.

Item 2.4: The role of Government

We believe that Government should play a greater role to co-ordinate national industry policy and strategy with respect to the financial sector, in particular through the promotion of financial services industry in Australia as an important business hub for Asia.

Item 3.1. The role and impact of new technologies, market innovations and changing consumer preferences and demography;

One area we feel we can comment on relates to new technologies in equity trading. We believe that research into technology such as Dark Pools should look at the relationship between dark trading and market quality. This should inform public policy issues related to non-displayed liquidity and to address market integrity rules.

Item 3.2. International integration, including international financial regulation

We recognise the importance in promoting international integration of financial markets and regulations that are facilitated by a network of professionals within an international organisation. The CFA Institute and CFA Societies through extensive research resources and a diverse international member base can assist in facilitating international integration of Australia's financial services, capital markets and financial regulation.

Item 3.3. Changes in the way Australia sources and distributes capital, including the intermediation of savings through banks, non-bank financial institutions, insurance companies, superannuation funds and capital markets.

We recognise the role of retirement security which is one of the focus areas for the CFA Institute Future of Finance initiative. The goal of this part of the initiative is to encourage sound retirement plans to protect pension systems worldwide based on an understanding of key issues.

Item 3.5. Corporate governance structures across the financial system and how they affect stakeholder interests

While perhaps not directly relevant to the Inquiry, we would like to comment on corporate governance practices in listed equity markets. Good corporate governance practices which ensure that companies act in the best interests of shareholders at all times, are critical to an effective investment industry. This is accomplished through the implementation of various internal controls and procedures, such as an independent and qualified board, accessible shareholder rights and transparent corporate communications and disclosure.

Item 4.1. Promote a competitive and stable financial system that contributes to Australia's productivity growth;

As a global profession, CFA Institute and CFA societies worldwide are concerned about how systemic risk affects the stability of financial systems. Insights can be gained from findings of the Systemic Risk Council (SRC) which was formed by CFA Institute and The Pew Charitable Trusts to monitor and encourage regulatory reform of U.S. capital markets focused on systemic risk.

2. Addressing the Terms of Reference in Detail

Terms of Reference Item 1: The Inquiry will report on the consequences of developments in the Australian financial system since the 1997 Financial System Inquiry and the global financial crisis, including implications for:

Item 1.3. The current cost, quality, safety and availability of financial services, products and capital for users.

CFA Societies Australia believe that improvements can be made in this area by wider adoption in Australia of consistent standards established globally by the CFA Institute. These include: the Code of Ethics and Standards of Practice; the Asset Manager Code of Conduct; and the Global Investment Performance Standards.

An integral part of the CFA Institute mission is to develop and administer codes, best practice guidelines, and standards to guide the investment industry. These standards help ensure all investment professionals place client interests first. Three codes are described below. For more information on CFA Institute's *Codes, Standards and Guidelines* including the Pension Trustee Code of Conduct please visit the CFA Institute website.

a) Code of Ethics and Standards of Professional Conduct

The Code of Ethics and Standards of Professional Conduct ("Code and Standards") are the ethical benchmark for investment professionals around the globe, regardless of job title, cultural differences, or local laws. All CFA Institute members or CFA Program candidates, are required to annually attest that they adhere to the Code and Standards.

The Code of Ethics maintains that you must:

- Place the integrity of the profession and the interests of clients above your own interests
- Act with integrity, competence, and respect
- Maintain and develop your professional competence

The Standards of Professional Conduct cover:

- Professionalism and integrity of the capital markets
- Duties to clients and employers
- Investment analysis and recommendations
- Conflicts of interest and your responsibilities

b) Global Investment Performance Standards (GIPS)

The GIPS standards are a set of standardised, industry-wide principles that guide investment firms on how to calculate and report their investment results to prospective clients[1]. CFA Institute encourages firms to voluntarily adopt these standards.

When investment firms/managers follow global standards for presenting investment performance, it gives investors the transparency they need to compare and evaluate investment managers. Outside of Australia it is standard practice to adopt the Global Investment Performance Standards. Their take up domestically has been very limited, despite a growing number of portfolio management services being offered to investors (eg. managed accounts) in recent years. We believe a wider adoption of GIPS will assist Australian consumers in comparing investments.

c) Asset Manager Code of Professional Conduct

CFA Institute offers this voluntary code of conduct to help asset managers practice ethical principles that put client interests first[2]. By helping investors identify asset managers who have committed to high standards of professional conduct, we are building the integrity of the investment industry.

It states that managers have these responsibilities to their clients:

- To act in a professional and ethical manner at all times
- To act for the benefit of clients
- To act with independence and objectivity
- To act with skill, competence, and diligence
- To communicate with clients in a timely and accurate manner
- To uphold the rules governing capital markets

[1] GIPS compliant firms in Australia include Colonial First State Global Asset Management and Wellington Management.

[2] In Australia six firms claim compliance with the AMC: Constellation Capital Management Ltd, Magellan Financial Group, Fortius Funds Management Pty Ltd, Wingate Asset Management, Industry Funds Management Pty Ltd and Brook Asset Management Ltd

Terms of Reference Item 2: The Inquiry will refresh the philosophy, principles and objectives underpinning the development of a well-functioning financial system:

Item 2.1. Balancing competition, innovation, efficiency, stability and consumer protection;

Putting Investors First is one of the topics of interest within the CFA Institute's Future of Finance initiative. We believe the fiduciary duty of advisors, brokers, investment managers and asset owners is critical in ensuring consumer protection within the industry.

We have three different materials which we believe are relevant to the Inquiry.

<u>Training of Financial Advisors</u>

CFA Societies Australia made a submission in September 2013 to ASIC on Consultation Paper 212: Training of financial product advisers – Update to RG146 where we emphasised sound ethical practices, financial knowledge and professionalism within the financial industry.

The purpose of the consultation was to seek comments and feedback on proposed changes to RG146 which details the minimum training standards for financial product advisers providing advice to retail clients. A summary of the CFA Societies views is below:

We strongly believe that greater knowledge and skills are critical for improving the quality of advice being provided by advisers. In particular we were very happy ethics has been introduced as a generic knowledge topic in the proposed changes. Having a framework for understanding ethical issues if and when they arise is very beneficial as it helps individuals recognise areas that are prone to ethical pitfalls and equips them with strategies to deal with them.

A strong foundation in ethical principles and standards is essential for everyone working within the financial industry especially those who provide financial advice. Investors need confidence that advisers will act with integrity and put their interests first.

We strongly believe that greater knowledge and skills are critical for improving the quality of advice being provided by advisers. However, we are not certain the improvements proposed in CP 212 will go far enough to truly raise the quality and standard of advice. In its current state RG 146 is inadequate and the improvements proposed should be viewed as a necessary first step towards a longer term goal. We continue to support a national certification exam for financial product advisers, as proposed in

Consultation Paper 153, as a framework for ensuring consistency of knowledge and skill across the industry.

While high ethical standards should be in-built in all financial professionals - knowledge and skill provide the tools advisers need to carry out their role effectively. An exam which is built around the basics of investment and technical fundamentals and underpinned by ethical and professional standards should benefit advisers, and if applied correctly, it should subsequently lead to better quality advice to consumers. Higher educational standards, teamed with ongoing continuing education should establish a level of professionalism within the industry, which ultimately will help raise the credibility and trust investors and the public have for advisers.

Statement of Investor Rights:

The Statement of Investor Rights was developed by CFA Institute in 2013 as part of the Future of Finance Initiative and represents ten rights that any investor should expect from financial service providers. It was developed to advise buyers of financial service products of the conduct they are entitled to expect from financial service providers, based on the CFA Institute Code of Ethics and Standards of Professional Conduct.

It states that when engaging the services of financial professionals and organizations, investors have the right to:

1. Honest, competent, and ethical conduct that complies with applicable law;
2. Independent and objective advice and assistance based on informed analysis, prudent judgment, and diligent effort;
3. My financial interests taking precedence over those of the professional and the organization;
4. Fair treatment with respect to other clients;
5. Disclosure of any existing or potential conflicts of interest in providing products or services to me;
6. An understanding of my circumstances, so that any advice provided is suitable and based on my financial objectives and constraints;
7. Clear, accurate, complete, and timely communications that use plain language and are presented in a format that conveys the information effectively;
8. An explanation of all fees and costs charged to me, and information showing these expenses to be fair and reasonable;
9. Confidentiality of my information;

10. Appropriate and complete records to support the work done on my behalf.

For the expanded Statement of Investor Rights please refer to the CFA Institute Website.

Restricting Sales Inducements

A CFA Institute position paper released in 2013 on the perspectives on the availability and quality of financial advice for individual investors[3]. This study examines the consequences of a ban on sales inducements across global financial markets, including Australia. Market analysis was supplemented with a survey of over 26,000 CFA charterholders in regards to their thoughts on various approaches to dealing with mis-selling.

Policy considerations for effectively dealing with mis-selling:

1) Increased transparency

Simplified disclosures that give investors the information they need to make informed decisions can only improve the investment experience. *Transparency should start with fee transparency*. *Investors need to be informed about all the fees that they are paying and about the origin of each of those fees* (from the adviser, the distributor, or any other participant). It is also important to pursue *uniformity in fee disclosures* across jurisdictions to allow comparability of fees across markets.

2) Investor education

Investor education is needed so that investors can make informed decisions. All the information in the world is not useful if investors do not know what to do with it or how to interpret it. The need for investor education is heightened in jurisdictions that have banned inducements. Investors in those jurisdictions with fewer assets to invest may find themselves underserved by larger firms, necessitating a move to execution-only businesses that are low cost but offer little or no advice. *Investors' behavioural biases and habits need to be addressed* through education as well.

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[3] See CFA Institute, 2013, *Restricting Sales Inducements* (December): http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2013.n15.1

3) Better access to quality, unbiased investment advice

Although low-cost investing with no advice attached may be right for the well-informed, financially literate investor, regulators and investment firms need to work together to promote *greater investor access to quality, unbiased investment advice* that falls along a continuum from those needing almost no advice to those needing a great deal.

4) Product differentiation

Financial services providers can also differentiate their products to better serve investors with diverse needs.

5) Removing tiered commissions

Financial firms can promote a more investor-friendly model that eliminates a major conflict of interest for advisers by *revising commission and remuneration structures* to eliminate those that encourage volume sales (tiered commissions).

6) Setting equal commission levels

Setting equal commission levels (as a percentage of management fee) for all products in the same category could also help eliminate some conflicts of interest in the adviser–client relationship.

7) Consistent and quality adviser training

Training is needed to promote high-quality advice as well as help eliminate conflicts when possible and mitigation when conflict elimination is impractical. Advisers need to be trained to put their clients' interests first and to always disclose potential conflicts to clients.

8) Increase product competition

To foster greater competition in the marketplace, regulators should explore ways to promote distribution models with what is called an "*open-architecture*", which allows bank or insurance company clients to have a choice of financial products issued by other institutions, thereby increasing product competition in the marketplace.

Item 2.2. How financial risk is allocated and systemic risk is managed;

The Systemic Risk Council (SRC) was formed by CFA Institute and The Pew Charitable Trusts to monitor and encourage regulatory reform of U.S. capital markets focused on systemic risk. It was formed as part of the Future of Finance initiative – Safeguarding the System which aims to create a better understanding of and develop resolutions for existing and potential risks that could adversely impact the global financial system.

The SRC is a private sector, non-partisan body of former government officials and financial and legal experts committed to addressing regulatory and structural issues relating to systemic risk in the United States. It has been formed to provide a strong, independent voice for reforms that are necessary to protect the public from financial instability. The goal is to help ensure a financial system in which we can all have confidence.

We believe the resources and views of the SRC could be used by panel members when addressing the issue of systemic risk.

The SRC members are listed below for your reference. For more information on the SRC and its initiatives please refer to the Systemic Risk Council Website.

Chair: Sheila Bair, The Pew Charitable Trusts, Former FDIC Chair

Ricardo Delfin, Executive Director to the Chairman & Special Advisor

Senior Advisor: Paul Volcker, Former Federal Reserve Chair

Members:

- **Brooksley Born,** Former U.S. Commodity Futures Trading Commission Chair
- **Bill Bradley,** Former U.S. Senator (D-NJ)
- **William Donaldson,** Former U.S. SEC Chair
- **Harvey Goldschmid,** Columbia Law School, Former U.S. SEC Commissioner
- **Jeremy Grantham,** Co-founder & Chief Investment Strategist, Grantham Mayo Van Otterloo (GMO)
- **Richard Herring,** The Wharton School, University of Pennsylvania
- **Simon Johnson,** Massachusetts Institute of Technology Sloan School of Management

- **Hugh F. Johnston,** Exec. VP & CFO, PepsiCo
- **Ira Millstein,** Legal Counsel to SRC, Chair, Columbia Law School, Center for Global Markets and Corporate Ownership
- **Maureen O'Hara,** Cornell University Johnson School of Management
- **Paul O'Neill,** Former CEO, Alcoa, Former U.S. Treasury Secretary
- **John S. Reed,** Former Chairman and CEO of Citicorp and Citibank
- **Alice M. Rivlin,** Brookings Institution, Former Vice-Chair Federal Reserve Board
- **John Rogers,** CFA, President and CEO, CFA Institute
- **Chester Spatt,** Tepper School of Business, Carnegie Mellon University, Former U.S. SEC Chief Economist

Item 2.4: The role of Government

We believe that Government should play a greater role to co-ordinate national industry policy and strategy with respect to the financial sector. Government should also promote the financial services industry in Australia as an important business hub for Asia. Both of these roles will assist financial services in supporting a higher rate of growth for the economy as Australia has a well-developed market in financial services and Australia can provide an important facilitation role of best practices in financial markets and economic development in Asia. We can also learn from models of government support and financial markets policy implementation in Asian region countries such as Singapore, Hong Kong, and Korea as they are in the region and near time-zones in which Australia competes. In particular the specific role of government related agencies and associated regulations as policy implementation tools should be examined as to how they best support a higher rate of effective financial services and capital markets development.

CFA Institute can assist with perspectives of the role of government by connection to the 140 country CFA Societies in 62 countries and territories. These contacts can be facilitated by the CFA Institute regional representative offices in Hong Kong and London in addition to the head office in the US. Plans are in place for additional regional offices to be opened in China and India in the year ahead.

Terms of Reference Item 3: The Inquiry will identify and consider the emerging opportunities and challenges that are likely to drive further change in the global and domestic financial system

Item 3.1. The role and impact of new technologies, market innovations and changing consumer preferences and demography;

CFA Institute published a study "*Dark Pools, Internalisation, and Equity Market Quality"*, on the role of new technology in financial markets. The report was specifically on dark pool activity in the USA, looking at the relationship between dark trading and market quality[4]. The purpose of the research was to inform public policy issues related to non-displayed liquidity and to address market integrity rules.

Summary policy considerations are that although a wholesale revision of the market structure regulatory framework is not necessary, CFA Institute believe certain improvements are needed to ensure a level playing field and to support competition, particularly given the current trajectory of growth in dark trading. To that end, CFA Institute recommends the following considerations in regards to dark trading:

- Require internalization of retail orders to provide meaningful price improvement;
- Monitor growth in the proportion of dark trading volume, and take appropriate measures; and
- Improve reporting and disclosure around the operations of dark trading facilities.

CFA Societies Australia used the findings of this report to respond to ASIC's Consultation Paper 202 in May 2013 on Dark Liquidity and High-Frequency Trading. In addition to the recommendations above relating to dark liquidity, the submission's specific response to concerns surrounding high frequency trading was that we do not believe imposing a minimum resting time is the best method to correct market instability relating to 'excessive messaging'.

In the submission we stated that the most effective way to mitigate the technological and operational risks while ensuring the benefits of HFT are preserved is through exchanges taxing (through higher fees) excessive message traffic, rather than arbitrary restrictions on order submission set by regulators. Combined with robust filters and controls over algorithms and a consistent circuit-breaker policy applied

[4] See CFA Institute, 2012, *Dark Pools, Internalisation, and Equity Market Quality* (October): http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2012.n5.1

across exchanges, these measures can bolster investor confidence and help restore integrity to financial markets.

Item 3.2: International integration, including international financial regulation

We recognise the importance in promoting international integration of financial markets and regulations that are facilitated by a network of professionals within an international organisation. The CFA Institute and CFA Societies through extensive research resources and a diverse international member base can assist in facilitating international integration of Australia's financial services, capital markets and financial regulation.

The CFA designation is global and has become the most respected and recognised investment designation in the world. The curriculum of the CFA program is another aspect of the progress towards international integration of a high standard and globally portable financial markets training. There is a high degree of international content which has been developed over the last 20 years as the CFA program grew from being a predominantly US oriented training program to one that reflects the membership base globally.

There is a global network of members with more than 122,000 investment analysts, portfolio managers, investment advisors and other investment professionals in 145 countries. Our global membership known for their expertise and integrity is a great resource to leverage. CFA Institute conducts regular and ad-hoc surveys of the network on current investment topics to ensure its submissions and research reflect the global views of the membership. An example is the annual Global Market Sentiment Survey (GMSS).

The GMSS reflects the views and expectations of CFA Institute members on financial markets, integrity, ethics, and performance for the coming year. The 2014 findings, drawn from more than 6,500 surveyed members in over 110 countries, have been used by financial professionals and media outlets such as The Wall Street Journal and Bloomberg to gauge opinion on the future of the financial industry.

The GMSS 2014 survey was able to draw out the opinions of Australian members. The survey found that concerns about mis-selling by financial advisers have increased significantly over the past year in Australia. Almost half (48 percent) of Australian members responding to survey regard mis-selling as the most serious ethical issue facing the local market in the coming year, rising from 36 percent last year. To review the complete report and survey results, visit www.cfainstitute.org/gmss.

The CFA Institute is a global thought-leader in the areas of ethics, capital market integrity, and excellence of practice. CFA Institute provides globally consistent best practices which can benefit companies and organisations in the global financial system as they can achieve consistent compliance from a regulation and reporting point of view. Some examples of globally consistent standards are the Global Investment Performance Standard (GIPS), the Asset Manager Code of Professional Conduct and Principles for Investment Reporting.

For more information on CFA Institute's *Codes, Standards and Guidelines* please visit the [CFA Institute website](#).

a) Global Investment Performance Standards

The GIPS standards are a set of standardised, industry-wide principles that guide investment firms on how to calculate and report their investment results to prospective clients[5]. CFA Institute encourages firms to voluntarily adopt these standards.

When investment firms/managers follow global standards for presenting investment performance, it gives investors the transparency they need to compare and evaluate investment managers. Outside of Australia it is standard practice to adopt the Global Investment Performance Standards. Their take up domestically has been very limited, despite a growing number of portfolio management services being offered to investors (eg. managed accounts) in recent years. We believe a wider adoption of GIPS will assist Australian consumers in comparing investments.

b) Asset Manager Code of Professional Conduct

CFA Institute offers this voluntary code of conduct to help asset managers practice ethical principles that put client interests first[6]. By helping investors identify asset managers who have committed to high standards of professional conduct, we are building the integrity of the investment industry.

It states that managers have these responsibilities to their clients:

- To act in a professional and ethical manner at all times
- To act for the benefit of clients

[5] GIPS compliant firms in Australia include Colonial First State Global Asset Management and Wellington Management.

[6] In Australia six firms claim compliance with the AMC: Constellation Capital Management Ltd, Magellan Financial Group, Fortius Funds Management Pty Ltd, Wingate Asset Management, Industry Funds Management Pty Ltd and Brook Asset Management Ltd

- To act with independence and objectivity
- To act with skill, competence, and diligence
- To communicate with clients in a timely and accurate manner
- To uphold the rules governing capital markets

c) The Principles for Investment Reporting

The Principles of Investment Reporting serve to facilitate a dialogue between report preparers and users. The principles specifically address reporting to existing clients, whereas the widely implemented Global Investment Performance Standards (GIPS) address presentation primarily to prospective clients. The Principles were developed as part of the Future of Finance initiative and is an example of a program of work on a global basis that aims to raise standards of financial markets and participants globally.

The five principles:

1. Communication occurs between the preparer and the user as to the purpose of and need for investment reporting
2. Control processes, policies, and procedures are documented and followed
3. Client preferences are reflected in the investment report
4. Clear and transparent presentation of investment risks and results
5. Comprehensive fee disclosure

Item 3.3. Changes in the way Australia sources and distributes capital, including the intermediation of savings through banks, non-bank financial institutions, insurance companies, superannuation funds and capital markets.

CFA Institute has included retirement security as one of the focus areas for the Future of Finance initiative. The goal of which is to encourage sound retirement plans to protect pension systems worldwide based on an understanding of key issues.

New resources are being developed on this important topic to help both retail and institutional investors. These resources include:

1. **Essentials of a More Secure Retirement**: A set of simple guidelines to encourage retail investors to save for their retirement.

2. **Retirement Security Research Summary**: After thorough research into the landscape of organizations that study retirement and pension issues, CFA Institute has compiled a set of slides that outline the challenges and give a summary of the issues addressed in our publications inventory, with very notable contributors in the field.

Another current resource is a thought-leadership piece on Life Annuities, *Life Annuities: An Optimal Product for Retirement Income.* This research piece one of the many research pieces produced by the CFA Institute Research Foundation. The Life Annuities paper written in 2013, is the most read research foundation piece to date.

The CFA Institute Research Foundation is a not-for-profit organization that sponsors independent research for investors and investment professionals around the world. The foundation's activities supports the exploration of new and challenging topics in investment management.

Currently funded projects include derivatives, management selection, environmental assets and liabilities, exchange traded funds and hedge funds. Other areas where extensive research has been done include economics, equity investment and risk management.

For more information on the Research Foundation or to download any research please visit the CFA Institute website.

Item 3.5. Corporate governance structures across the financial system and how they affect stakeholder interests

An effective investment industry and ultimately, retirement security, depends on the quality of corporate governance practices across listed equity markets. We believe solid corporate governance practices are an essential part of ensuring shareholder value is protected and the rights of shareholders are promoted. Good corporate governance practices seek to ensure that companies act in the best interests of shareholders at all times. This is accomplished through the implementation of various internal controls and procedures, such as an independent and qualified board, accessible shareholder rights and transparent corporate communications and disclosure.

CFA Societies Australia addressed corporate governance structures in its submission to the ASX Corporate Governance Council on the review of its *Corporate Governance Principles and Recommendations* (‘*Principles and Recommendations*’) in November 2013. CFA Societies Australia was very supportive of the proposed changes the ASX Corporate Governance Council is making to improve corporate governance practices among listed entities.

Our key recommendations included support for:

- Increased disclosure and transparency around matters affecting shareholder’s right to make informed decisions about director election;
- Greater risk oversight by the board, as we believe risk thinking needs to be embedded in the way businesses are run and overseen; and
- Broader definition of director independence.

Corporate governance practices are examined in a CFA Institute study “*Visionary Board Leadership: Stewardship for the Long Term*”[7]. In this study an expert panel of current and former directors, investors, corporate secretaries, and other investment professionals was used to characterise a ‘Visionary Board’ by identifying leading board practices. The aim of this report is to highlight leading practices that demonstrate vision and leadership toward addressing the issue of short-termism.

The report examines six key focus areas that board directors can influence to ensure their companies are focused on long-term value. A summary of the recommendations for each area:

- **Earnings Reporting Practices** - A Visionary Board expects management to deliver investor guidance with a longer-term bias and in greater detail by identifying long-term value drivers for the company. This approach helps to incentivise share “ownership” among the investors the board represents.
- **Shareowner Communications** - A Visionary Board proactively listens to the concerns of its shareowners and consistently communicates its long-term vision and strategy.
- **Strategic Direction** - A Visionary Board actively oversees and understands the corporate strategy and regularly monitors, along with management, the implementation and effectiveness of strategic

[7] See CFA Institute, 2012, *Visionary Board Leadership: Stewardship for the Long Term* (June): http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2012.n3.1

plans. A Visionary Board also focuses on the relationship between corporate strategy and risks associated with that strategy.

- **Risk Oversight** - A Visionary Board embraces risk as a board-level responsibility. It oversees robust processes for identifying, understanding, and when necessary, mitigating risks to the operations, strategy, assets, and reputation of the company. At the same time, a Visionary Board understands that companies generate profits by taking risks and encourages intelligent risk-taking that aligns with the company's strategy.
- **Executive/Director Compensation** - A Visionary Board understands a company's compensation policies and ensures that the underlying objectives consistently support the long-term strategy and performance of the company, as well as the appropriate company risk profile.
- **Board and Corporate Culture** - A Visionary Board not only understands the business and industry in which the company operates but also recognizes that strong corporate and board cultures are essential to the achievement and sustainability of a company's long-term value. Therefore, a Visionary Board diligently seeks to reinforce and build such cultures.

Terms of Reference Item 4: The Inquiry will recommend policy options that:

Item 4.1. Promote a competitive and stable financial system that contributes to Australia's productivity growth;

As a global profession, CFA Institute and CFA Societies are concerned about how systemic risk affects the stability of financial systems. Addressing this concern, the Systemic Risk Council (SRC) was formed by CFA Institute and The Pew Charitable Trusts to monitor and encourage regulatory reform of U.S. capital markets focused on systemic risk.

As also mentioned in Item 2.2, the SRC was formed as part of the Future of Finance initiative – Safeguarding the System which aims to create a better understanding of and develop resolutions for existing and potential risks that could adversely impact the global financial system.

The SRC is a private sector, non-partisan body of former government officials and financial and legal experts committed to addressing regulatory and structural issues relating to systemic risk in the United States. It has been formed to provide a strong, independent voice for reforms that are necessary to protect the public from financial instability. The goal is to help ensure a financial system in which we can all have confidence.

The SRC members are listed below for your reference. For more information on the SRC and its initiatives please refer to the Systemic Risk Council Website.

Chair: Sheila Bair, The Pew Charitable Trusts, Former FDIC Chair

Ricardo Delfin, Executive Director to the Chairman & Special Advisor

Senior Advisor: Paul Volcker, Former Federal Reserve Chair

Members:

- **Brooksley Born,** Former U.S. Commodity Futures Trading Commission Chair
- **Bill Bradley,** Former U.S. Senator (D-NJ)
- **William Donaldson,** Former U.S. SEC Chair
- **Harvey Goldschmid,** Columbia Law School, Former U.S. SEC Commissioner
- **Jeremy Grantham,** Co-founder & Chief Investment Strategist, Grantham Mayo Van Otterloo (GMO)

- **Richard Herring,** The Wharton School, University of Pennsylvania
- **Simon Johnson,** Massachusetts Institute of Technology Sloan School of Management
- **Hugh F. Johnston,** Exec. VP & CFO, PepsiCo
- **Ira Millstein,** Legal Counsel to SRC, Chair, Columbia Law School, Center for Global Markets and Corporate Ownership
- **Maureen O'Hara,** Cornell University Johnson School of Management
- **Paul O'Neill,** Former CEO, Alcoa, Former U.S. Treasury Secretary
- **John S. Reed,** Former Chairman and CEO of Citicorp and Citibank
- **Alice M. Rivlin,** Brookings Institution, Former Vice-Chair Federal Reserve Board
- **John Rogers, CFA, President and CEO, CFA Institute**
- **Chester Spatt,** Tepper School of Business, Carnegie Mellon University, Former U.S. SEC Chief Economist

CFA Societies Australia

3. Short Background to the CFA Institute

As a member-based organisation with representation across the full range of financial services sector, we believe our submission on this consultation represents an independent voice without the conflicts of interest that may face any particular industry association. We thank you for the opportunity to highlight and share our resources with the Inquiry and contribute to improving the financial system in Australia.

The three Australian chapters of CFA Institute (the CFA Societies of Sydney, Melbourne and Perth) are part of the CFA Institute, a global, not-for-profit professional association of more than 122,000 investment analysts, portfolio managers, investment advisors and other investment professionals in 145 countries. More than 112,000 members are holders of the CFA designation. The CFA Institute membership also includes 140 member societies in 62 countries and territories. In Australia we have over 1,900 members, who are engaged in a wide variety of senior roles across investment management and advice. Most of our members are holders of the Chartered Financial Analyst® (CFA®) designation.

The mission of CFA Institute is "To lead the investment profession globally by promoting the highest standards of ethics, education, and professional excellence for the ultimate benefit of society". It is a leading voice on global issues of fairness, market efficiency, and investor protection through its deep understanding of global best practice and the ability to leverage a large global network of charterholders and global resources.

CFA Institute offers a range of educational and career resources, including the Chartered Financial Analyst (CFA) and the Certificate in Investment Performance Measurement (CIPM) designations, as well as a new program called the Claritas Investment Certificate[8]. Our educational programs, independent research and codes and standards all have a deep foundation in ethical principles and professional standards, which we believe are fundamental to building trust and confidence in the capital markets and the investment profession. The CFA Institute has an ongoing program of work under the Future of Finance initiative that addresses many of the areas under consideration by the Inquiry.

[8] For more information on CFA Institute's education programs please visit http://www.cfainstitute.org/programs/Pages/index.aspx

CFA Societies Australia

4. About the CFA Institute Future of Finance Initiative

The Future of Finance initiative is an ongoing global effort to shape a trustworthy, forward-thinking financial industry that better serves society. The initiative aims to provide the tools to motivate and empower the world of finance to commit to fairness, improved understanding, and personal integrity.

The Future of Finance initiative is focused on six primary topics of interest, including putting investors first; safeguarding the system; retirement security; financial knowledge; regulation and enforcement; and transparency and fairness. The initiative is starting to develop rigorous research and recommendations to address each area, and is producing accessible tools to encourage broad adoption and widespread change throughout the global financial system.

Led by the CFA Institute, the initiative is overseen by an Advisory Council including prominent financial industry leaders. The Future of Finance initiative is a permanent initiative of CFA Institute globally and is fully supported locally at the society level.

Future of Finance Advisory Council members:

- **Chair, John Kay** is a distinguished academic, economist and businessman, an adviser to companies and governments around the world and an acclaimed columnist.
- **Keith Ambachtsheer** is director of the Rotman International Centre for Pension Management (Rotman ICPM), an adjunct professor of finance at the Rotman School of Management at the University of Toronto, academic director of the Rotman ICPM Board Effectiveness Program and publisher and editor of the *Rotman International Journal of Pension Management*.
- **Paul Chow Man-yiu** is a retired finance industry executive who served most recently as chief executive and executive director at the Hong Kong Exchanges and Clearing Limited (HKEx).
- **Elizabeth Corley** is CEO of Allianz Global Investors, a global asset manager within Allianz's asset management division.
- **Andrew W. Lo** is Charles E. and Susan T. Harris Professor of Finance at the MIT Sloan School of Management and the director of MIT's Laboratory for Financial Engineering.
- **Tom Keene, CFA**, is an editor-at-large at Bloomberg News and host of *Bloomberg Surveillance*, Bloomberg's morning program for economics, finance and investment.
- **Ira M. Millstein** is a senior partner at the international law firm Weil, Gotshal & Manges LLP, where he works in government regulation and antitrust law.

- **Ng Kok Song** is adviser and chair of global investments at the Government of Singapore Investment Corporation (GIC).
- **Barbara G. Novick** is vice chairman at BlackRock and a member of the Global Executive and Global Operating Committees at BlackRock.
- **Saker Nusseibeh** is CEO and head of investment at Hermes Fund Managers.
- **Robert C. Pozen** is a senior lecturer at Harvard Business School and a senior fellow at the Brookings Institution.
- **Mary Schapiro** is former chairman of the U.S. Securities and Exchange Commission (SEC) and is managing director at Promontory.
- **Andrew Sheng** is president at Fung Global Institute. Previously, he served as chairman of the Securities & Futures Commission of Hong Kong and as a central banker at the Hong Kong Monetary Authority and at Bank Negara Malaysia.
- **Robert J. Shiller** is Sterling Professor of Economics at Yale University as well as a fellow and professor of finance at the International Center for Finance at the Yale School of Management.
- **John Taft** is CEO at RBC Wealth Management, United States, where he is responsible for RBC’s wealth management growth strategy in the United States.

CFA Societies Australia

5. Australian CFA Membership Survey, February 2014

Local Member Input

In February 2014, CFA Societies Australia carried out a survey of its membership throughout Australia asking for feedback on the Inquiry's Terms of Reference. The main themes to come out of the survey include comments on Australia's superannuation system, Australia's competitive position and disclosure and transparency. These themes from the comments have been grouped by Terms of Reference item areas where possible below.

Summary of Responses referenced to Item Area

Item 1.1:

Lack of a deep and mature domestic bond market impedes Australia funding its own growth.

Item 2.1:

The Australian financial system should have a foundation of ethical behaviour.

Item 2.3:

Regulation is especially onerous for firms dealing with retail investors.

Item 2.5:

Global Regulator cooperation and Australian regulator recognition by other regulators

Item 3.3:

Reforms to encourage growth in Australia's funds management industry

What is the impact of the growth of SMSFs on retirement savings adequacy?

What determines an appropriate level of superannuation contributions?

Australian capital market efficiency could be improved by engaging with gatekeepers such as asset consultants on both the institutional and retail side of financial services.

Item 3.5:

Regulations could strengthen corporate governance standards and accountability of Boards.

There should be increased oversight of all financial products and listed companies' reporting.

There should be improved reporting of listed companies exposure to financial products, particularly derivatives.

Managed fund performance reporting should be in line with global standards.

Item 4.2:

Structures such as managed funds are expensive to set up in Australia compared to other locations, and these costs should be reduced.

Financial product competition could be improved by reducing the dominance of big 4 banks in wealth management.

The superannuation sector and regulator’s focus on fees may be compromising choice and net returns.

Item 4.3:

There should be more use of in annuity style products for post-retirement incomes with the right incentives.

Requirements for after-tax fund reporting standards would better address investors’ needs.

Better financial education could be incorporated into the primary and secondary school curriculum.

Should the same level of information disclosure be provided to both institutional and retail investors?

There could be some exceptions from disclosure allowed for institutional investors.

To what extent should there be simultaneous and equitable disclosure.

Is less disclosure more effective for companies and financial products?

There should be more of a focus on fiduciary duty and stewardship to enable higher standards of advice.

Item 4.4:

There is a need for support and funding options for innovative small company start-ups

Government policy should help facilitate smaller companies' development into the larger global companies of the future.