Royal Commission into Misconduct in the Banking, Superannuation, and Financial Services Industries

25 October 2018

Submission on Policy Issues Raised in Round 6

PRINCIPAL MEMBERS

Thank you for the opportunity to provide comment to the Royal Commission on Policy Issues Raised in Round 6.

The GRC Institute is a membership based organisation for compliance and risk professionals throughout Australia, New Zealand and Hong Kong. Our members work for a variety of organisations both within financial services and much wider.

Our submission has been put together based on our years of experience with our members' working with advisers and their feedback on their experiences with building compliance frameworks and education programs to assist them with being compliant and providing positive outcomes for their clients. We will attempt to be practical and constructive in our response to this draft and provide insights from our members' experience, successes and failures.

General feedback:

Our first observation is that the use of the term 'compliance' and 'compliance schemes or frameworks' throughout the whole of the testimony of the Commission has demonstrated clearly that both regulators and the regulated continue to struggle to understand how a compliance framework can be utilised, who should perform that work, who they should report to and the responsibility of business to be accountable for compliant conduct, rather than continually expecting it to be 'done by someone else' – presumably in the back office, fixing all their mistakes.

This has not been surprising to GRCI or our members. We have some essential feedback that we are providing in response to the report as a whole, however, this view that compliance and compliance professionals are under resourced, not utilised correctly in organisations, placed in the wrong positions in the structure of the organisation and should very definitely have a clear reporting line to their boards and protections if they need to go directly to the regulator, informs our below feedback.

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Responses to questions:

1. Is the current regulatory regime adequate to minimise consumer detriment:

The quantum of civil penalties are not the issue. If the chances of being caught are minimal and there is very little likelihood of criminal penalties being applied to directors and officers of large corporations then firms will continue to treat the regulatory regime as merely a business risk to be controlled. The law should be enforceable and enforced.

If the current regulatory regime is not adequate to achieve that purpose, what should be changed?

The current regulatory regime is directed at the industry to the (almost) total exclusion of the consumer. The growth of litigation funders and class actions has been one response to this. Consideration should be given to providing regulatory solutions for consumers and getting serious about encouraging and protecting whistleblowers (current regime, including the recent changes) are derisory. Compliance officers should be involved with the management of whistleblower schemes and have some statutory protection (e.g. duty to public to override duty to one's employer) to enable them to do so.

2. Are there particular products - like accidental death and accidental injury products - which should not be sold?

On the one hand, as long as the product benefits and costs can be explained and ARE explained and the customer actually needs the product then it can be fine. However, as observed throughout the testimony, it does not appear that any rigorous process is consistently applied across organisations to ensure all of these things happen.

It also depends on the complexity of the products and conditions. Consideration should be given to limiting or prohibiting the offering of certain leveraged products (esp. CFD's, Leveraged FX products and financial spread betting) to retail investors and inexperienced wholesale investors. They are banned in many other countries. The "disclosure" style of regulation promulgated by the Australian regulatory regime is grossly inadequate for these type of products.

Stronger product approval processes need to be in place before products are launched and ongoing monitoring needs to also be in place within organisations to ensure that what might begin as a fairly benign product under

particular conditions, isn't later manipulated or evolves into something else once it moves into other areas of the business, beyond the control of those who initially designed and signed off on it.

4. Is the current disclosure regime for financial products set out in Chapter 7 of the Corporations Act 2001 (Cth) and Division 4 of Part IV of the Insurance Contracts Act 1984 (Cth) adequately serving the interests of consumers?

No. The current disclosure regime is actually inimical to the interests of consumers if a significant number of consumers are not reasonably capable of understanding the complexities and risks of the products being offered. More documentation is not the answer. Further the demands put on intermediaries by this increasingly complex and byzantine financial planning disclosure regime are quite unreasonable as they are often not capable of being executed by normal (even where well educated) financial planners in a commercial environment.

If not, why not, and how should it be changed?

Reducing product complexity and enhancing clarity makes compliance easier to achieve and regulate.

7. Should monetary and non-monetary benefits given in relation to general insurance products remain exempt from the ban on conflicted remuneration in Division 4 of Part 7.7A of the Corporations Act 2001 (Cth)?

There should be no exemptions. Conflicts of interest are conflicts of interest where ever they occur. They have proven impossible to manage and difficult for people to understand.

9. Is banning conflicted remuneration sufficient to ensure that sales representatives do not use inappropriate sales tactics when selling financial products? Are other changes, such as further restrictions on remuneration or incentive structures, necessary?

No it won't be enough. Incentives for compliance need to be in place and disincentives for poor behaviour.

10. If the current regulatory regime is not adequate to achieve that purpose, what should be changed?

This is a very big question, but it needs to be recognised that disclosure alone is not sufficient in many cases - such as complex or high risk products. There should be another pathway.

11. Is Recommendation 10.2 from the Productivity Commission's report on 'Competition in the Australian Financial System', published in June 2018, sufficient to address the problems that can arise where financial products are sold under a general advice model (for example, the sale of financial products to consumers for whom those products are not appropriate)?

Recommendation 10.2 is just a starting point. Consideration should be given to aligning Australian definitions with those in other comparable jurisdictions. Agree that the term "general advice" as used in the Australian regime is misleading and not fit for purpose.

Are there some financial products that should only be sold with personal advice?

Yes. High risk (however defined) and complex products should only be sold with personal advice.

16. If the ban on conflicted remuneration is not extended to apply to general insurance products, should the payments of commissions for the sale of add-on insurance by motor dealers be limited or prohibited?

They should all be banned.

22. Should the General Insurance Code of Practice be amended to provide that, when making a decision to cash settle a claim, insurers must:

act fairly; and

ensure that the policyholder is indemnified against the loss insured (as, for example, by being able to complete all necessary repairs)?

Isn't this already in law? What would this improve? It just needs to be actually enforced and have decent penalties.

26. Should RSE Licensees be prohibited from engaging an associated entity as the fund's group life insurer?

If they can't eliminate a conflict and demonstrate that they can actually do this.

28. Are the terms set out in the Insurance in Superannuation Voluntary Code of Practice sufficient to protect the interests of fund members?

No - it's not enforceable. What's more, voluntary codes should not be used as regulatory tools; although they could be taken into account by regulators and courts when establishing what represents "good practice" in the industry.

36. Is there sufficient external oversight of the adequacy of the compliance systems of financial services entities?

ASIC and APRA have traditionally not spent much time looking at the compliance systems which need to be embedded into Australian Financial Services Businesses.

ASIC tends to be involved at a tactical level in respect of breaches but does not appear to measure or assess adequacy of compliance systems. ASIC AFSL holders are subject to an independent licence audit; however, the audit is paper based and does not look at issues such as adequacy of resources or sustainability of systems. The audit generally looks at things like Complaints registers, and reporting. Adequacy of resources seems to be accepted as long as things link the complaints registers are in place.

APRA tends to operate at a more thematic level and whilst they concern themselves with risk management frameworks and resourcing around risk and compliance they, to date (other than in the APRA paper on CBA) have provided very little comment around adequacy of compliance systems.

Resourcing is not simply a question of numbers of head count in a compliance team/project but is around appropriateness of the positioning of compliance within the organisation, level of authority the compliance team possess and sufficiency of second line testing and monitoring.

This often means that compliance officers are spending the majority of their time completing these reports. It would be fair to say that they don't really know what they are looking for. Suggestions to test the adequacy of compliance systems would be as follows.

1. As part of regulator reviews, measure against ISO 19600.
2. Benchmark resourcing numbers and skills required for the different types of businesses being regulated.
3. Measure compliance functions against the benchmark.
4. Interview compliance personnel, below management level. (Consider interviewing them without management in the room.
5. Request details of the skills, qualifications, etc. within a business's compliance function.
6. As regulators, source compliance experts to help assess the general condition of businesses, and make that part of the regular review process.
7. Consider the right to veto appointments of CCO and senior managers. There have been many CCOs appointed across the big 4 who have no meaningful compliance experience.

8. Ask for information about compliance staff turnover. Turnover in the compliance function is generally symptomatic of a poor compliance culture, or under resourcing.

Should ASIC and APRA do more to ensure that financial services entities have adequate compliance systems?

Yes, including an appropriately qualified compliance professional/team including ongoing CPD, direct line reporting and protections if need to go directly to the regulator.

ASIC and APRA should be providing more guidance to entities around how to establish, train and maintain their compliance teams and providing examples of what "good looks like" with respect to adequate compliance systems.

ASIC and APRA should consider the minimum skills and expertise required to be a Compliance Officer and work with industry bodies such as the Governance Risk and Compliance Institute to ensure there are readily available accreditations to ensure appropriate benchmark standards for compliance professionals.

Care should be taken with 'RegTech' offerings – whilst these may provide some benefits the concept of a separate system to check/monitor compliance can be counterproductive rather compliance should utilise systems that are in play in the sales/business area as these will be utilised by the sales and operations teams and form a source of truth. Moving data to another system can be time and money consuming and still not provide the best basis for assessment. "RegTech" can be a diversion of resources and should be considered carefully.

37. Should there be greater consequences for financial services entities that fail to design, maintain and resource their compliance systems in a way that ensures they are effective in:

preventing breaches of financial services laws and other regulatory obligations; and

ensuring that any breaches that do occur are remedied in a timely fashion?

Yes, at senior management and director level penalties. It is those people who make those decisions and withhold funding, support and cultural messaging.

Compliance has not necessarily been considered as a critical aspect of overall risk systems with potentially more attention being placed on areas of obvious financial risk. Non-financial risk areas underpin many of the operational aspects of financial services and need to be given appropriate attention and resources.

There appear to be significant issues around assessing and remediating breaches. That said on occasion root cause analysis can take considerable time making the assessment of significance of breaches a lengthy process. Care needs to be taken that there is true risk management applied to the breach assessment process or this can devolve into a risk administration process rather than real risk management. In and risk-based approach one needs to consider the impact of the breach.

Breaches will always occur the question is whether they are significant or systemic and how much harm may be caused to consumers from the breach. Whilst a pricing issue may impact many consumers if it is quickly identified and remedied the impact should be minimal.

Whilst being a day late in sending in a report to a regulator may constitute a breach and be an indicator of potential issues around manual processing or access to data, it is more of an administrative issue than a consumer detriment issue.

Many small organisations struggle with the complexity of the current regulations/regulatory structure which gives rise to so many regulatory obligations and reporting requirements but many of which are more administrative in nature. Simplification of requirements within the legislation and guidance notes is imperative and needs to be actioned swiftly. Legislative changes are time consuming. Plain English drafting should be adopted.

Simplifying requirements to those that impact consumers most would reduce the amount of risk administration firms have to undertake and free up resources to concentrate on the areas of highest impact. Then providing practical guidance notes on application leaving little room for interpretation would assist smaller firms in applying requirements consistently.

Compliance officers should not normally be the individuals who would be charged with designing and embedding processes or remediating breaches. In order to facilitate this more effectively would be to provide:

1. Effective internal mechanisms for employees to escalate to the Board where required;

2. The ability to escalate to the regulator without fear of repercussion, and
3. Clear industry benchmarks about what is considered adequate resources.

38. When a financial services entity identifies that it has a culture that does not adequately value compliance, what should it do?

Tackle the issue head on – tone from the top is constantly referenced but 'mood in the middle' is equally if not more important. Communications are key, people are generally compliant and want to do a good job and most want to serve their customers well and treat them as they would wish to be treated. Culture is pervasive – if junior team members see their peers and seniors doing the right thing they will follow those examples, similarly if there seems to be little care at higher levels that example will be followed. Communications and training need to be constantly reinforcing what good behaviours look like. Training does not need to be face to face lengthy sessions but can be short vignettes or posters around topics.

Additional money and resources can and should be applied to these reinforcement activities and the first line should be running the sessions with input from compliance i.e. this must not (solely) be a compliance led initiative. Efforts should be made to underline the benefits of positive culture and what this can do to positively impact sales performance.

We are not sure laws can shape culture but regulators can definitely play a role in shaping the culture of financial services. The Dutch and UK regulators have been making more meaningful regulatory efforts by laying ground for wide-ranging supervisory action in conduct and culture.

De Nederlandsche Bank, the Dutch central bank, has put in place a comprehensive supervisory framework on behaviour and conduct that is being looked at by many other regulators as a potential blueprint for others. The Financial Conduct Authority (FCA), in the UK, has been utlising a range of supervisory tools and methods to engage with firms individually on issues of conduct and culture, and pushing for enhanced rules on accountability, incentives, fair treatment of consumers and whistleblowing. Historically in the UK the Plain English campaign around "Treating Customers Fairly" provided excellent tools and training for firms. The New York Fed has been holding annual conferences or workshops on culture and behaviour in the financial services industry.

AUSTRAC has made real efforts to consider their audience when producing recent publications and has increased their public/private sector outreach to great effect.

ASIC and APRA should work with organisations such as the Governance Risk and Compliance Institute to provide training and reinforcement activities that will assist firms in highlighting the benefits of a positive culture.

This submission has been compiled from GRCI member feedback.

We would love to discuss our submission further, should you have any questions we can be contacted directly via our Sydney office.

Kind Regards,

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GRCI