

Submission to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Introduction

This submission outlines the case for additional work that should be undertaken by the Royal Commission regarding the capability and effectiveness Regulation and the Regulators of the financial system to identify and address misconduct.

ASICs work has three distinct and critical components (1) detection of misconduct, (2) enforcement action against misconduct, and (3) review of its capability and effectiveness in eliminating misconduct. Each of these components is critically important, as a deficiency in any one has the propensity to undermine the overall effectiveness of regulation.

The Commission has set out its interim findings about Regulation and the Regulators in Chapter 8 of the Interim Report, and based on the findings to date, it is evident that many questions remain unanswered and should be the subject of further investigation by the Royal Commission. This is particularly evident when it comes to 'detection of misconduct' and 'review of the capability and effectiveness' by ASIC, which is very barely addressed in the Interim Report.

Detection of Misconduct by ASIC

ASICs ineffectiveness in detection of misconduct likely explains the disperse views in the community regarding the need for a Royal Commission in the first place, with those listening to ASIC over the years concluding that little misconduct existed and so little could be gained from a Royal Commission, while those listening to complaints from customers and whistle-blowers and the like concluding that much misconduct existed and so much could be gained from a Royal Commission

The Royal Commission needs to conduct a detailed investigation of ASICs capability and effectiveness in the detection of misconduct. The reason for this is self-evident. If for example, ASIC is detecting (say) 25% of the misconduct, and even if enforcement action has a perfect record in eliminating the detected misconduct, its overall success in eliminating misconduct is only 25%.

The following questions (among others) should be put to ASIC:

- (1) What sources and methods does ASIC use to detect misconduct? Presumably, the following (non-exhaustive) list should be tendered (1) complaints to financial entities, (2) complaints to the financial ombudsman (3) complaints to parliamentary representatives (4) complaints to ASIC, (5) media and other investigations (6) whistle-blower revelations (7) audit reports (8) annual reports (9) self-reported breach notifications (10) random investigations of case files.
- (2) How does ASIC cross check the various sources above to analyse whether the information provided by financial entities is accurate, complete, and timely? For example, any complaint reported to the financial ombudsman that pertained to a breach notification should be cross checked to ensure that the breach notices were provided in an accurate and timely manner.
- (3) How does ASIC analyse audit reports to ensure that the auditors have properly done their job? Are instances of misconduct (that subsequently come to light) cross-referenced with the relevant audit report – to determine what further action is warranted against the auditor?

- (4) How does ASIC collate all the information to formulate a realistic picture of misconduct? For example, if it received (say) 100 reports of customers being charged for advice but without receiving that advice, how does ASIC determine the extent this misconduct and estimate the dollar amount of the misconduct.
- (5) How does ASIC prioritise the collated information, and formulate its best strategy, so that it achieves the best outcome for its available budget?
- (6) How can ASIC ever hope to properly detect misconduct, when whistle-blowers, such as Jeff Morris, are routinely ignored by ASIC?
- (7) How does ASIC undertake 'exploratory' investigations when a specific instance of misconduct is detected, to determine the scope and depth of that misconduct? For example, are the case files of the specific individual involved in the misconduct investigated, are other individuals undertaking similar work investigated, are other financial entities undertaking similar work investigated?
- (8) Why is ASICs assessment of misconduct that currently exists so at odds and information available in the public domain and with the findings of the Royal Commission?
- (9) What is preventing ASIC from effectively detecting misconduct, to a standard that would meet public expectations, and what steps has ASIC undertaken to address this problem?

Enforcement of Misconduct by ASIC

The enforcement of misconduct has been investigated in detail by the Royal Commission, with the results presented in Chapter 8 of the Interim Report. However, I would make the following observations.

- (1) While the public has every right to be outraged by the breadth and depth of misconduct by financial entities, it is important to realise that financial entities (like other corporate entities, such as multi-national technology companies) are duty bound to operate in their own self-interest (i.e. to maximise profits for shareholders), are not required to have any appreciation of a moral or ethical compass. It should be inconceivable that a regulator would not understand this and would not fully take this fact into consideration when determining its strategy to achieve a regulatory standard that will meet community expectations.
- (2) The current remuneration structure of most financial entities provides for bonuses and commissions that can exceed the base salary, especially for top executives and managers. The base salary could be considered the remuneration for simply doing their job, whereas the bonuses and commissions could be considered the remuneration for lifting sales and profits. As surely as night follows day, if the bonuses and commissions are large (relative to the base salary), individuals will focus on the activity that will provide the greatest remuneration and will also ensure that their staff are similarly focused in support this goal. Again, it is inconceivable that ASIC would not understand this and would not fully take this fact into consideration when determining such high-risk factors will most likely result in higher levels of misconduct and would not be suitably prepared.
- (3) It is bewildering that ASIC would be tasked with ensuring that misconduct meets community expectations, yet not be provided with clear and simple legislation that provides an enforceable code of conduct (that exactly reflected exactly community expectations). On the one hand, there is a code of conduct (that resides with the ABA) that purports to reflect community expectations but is not enforceable. On the other hand, there is legislation that can lead to criminal prosecution, but with such a high degree of difficulty, that it is deemed

impractical (by ASIC) within its current budget. It is a real mystery why ASIC does not have an enforceable code of conduct that meets community expectations, as exists elsewhere.

- (4) The Government has consistently reduced ASICs budget. From memory, this is pretty much what the USA government did (to their financial regulators) after 9/11 and prior to the GFC. If the Government has insufficient funds to properly fund ASIC, it is a mystery why doesn't the Government increase the fees to those entities that require a higher level of regulation (as well as directing the penalties paid by financial entities found guilty of misconduct to ASIC rather than to worthy charities) to fill in the funding gap.
- (5) Financial entities are required to return fees charged in error and (sometimes) pay penalties for misconduct, when it is proven. Where is the additional compensation that should be paid to the victims of misconduct (in addition to the amount that was wrongfully taken from them)? How can a penalty be calculated in such that the financial entity can be allowed to make a healthy profit on the transaction (even after refunding victims and paying the penalty)? How does ASIC ever expect such enforcement action to act as a deterrent to future and similar instances of misconduct?
- (6) If a SME is one day late in providing an ASIC annual return, it is hit with a late fee (no ifs, no buts), yet it seems that large financial entities can drag their heels for months, sometimes even longer, before complying with the law. How can ASIC expect to be taken seriously as a regulator, especially by those large financial entities, if it thrashes its own reputation by operating in such a manner?

Review of ASIC Capability and Effectiveness

ASIC is required to provide an annual report to the Government as well as front various Parliamentary Committees. The Government relies on ASIC to provide accurate, complete, and timely information so that it can ensure that misconduct is minimized and meets community as well as its own expectations. It is clear to everyone, except perhaps ASIC, that this has not been the case. There can be only one reason for this – that ASIC has not been able to competently review its own capability and effectiveness. Furthermore, if left to ASIC, the expectation is that this will continue.

The following questions (among others) should be put to ASIC:

- (1) Does the structure within ASIC reflect the three core components of regulation of i.e. misconduct, detection, enforcement, and review?
- (2) What works and what does not work, when it comes to regulating misconduct?
- (3) Is there a culture of 'box-ticking' (as opposed to critical investigation) within ASIC?
- (4) What additional resources and what different resources does ASIC need to enable regulation of misconduct to meet community expectations?
- (5) What does ASIC need to do differently to enable regulation to meet community expectations?
- (6) How does ASIC compare to other countries, and what could it learn from them?
- (7) Are Parliamentary committees the best way to scrutinize ASIC, or should the Government appoint an independent expert body to undertake this task in addition to members of Parliament?
- (8) How does ASIC explain why its own assessment of its capability and effectiveness is so at odds with public perception and the findings of the Royal Commission?
