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

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Through its public hearings in particular, the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry has thrown the spotlight on some of the more egregious elements of the operational culture of the Australian financial sector. Societies, firms, professional associations, specific industries and other groups (including regulatory actors), develop modes of preserving and transmitting through time and generations the mental programming that constitute routines, or *the ways that things are done*. These processes may be difficult to discern specifically, but none the less are well understood not only by those who may be involved directly, but also by those who are not.[1] These mental programs interact with individual and collective value systems, which simultaneously are reflexively interacting with prevailing cultural influences, and thus inevitably shape behaviours. So, specific sites, whether industry-wide or sales units within individual organisations for example, develop patterned modes and mechanisms for evaluating issues and events. In turn these are transmitted not only within their core groups but also to the broader populations at home, and abroad, as the routine and legitimate ways of doing business – in short, the operational culture of an industry or organisation.[2]

Unsurprisingly this operational culture of the industry interacts reflexively with regulatory actors and helps to shape the intensity and extent of how regulation is enforced. This is an important explanatory factor for what the Interim Report notes as regulatory responses to financial scandals that are often disappointingly: '..focused on the remediation of specific instances of poor advice, rather than seeking to identify root causes within institutions and the industry. Those responses largely set the tone for future approaches to misconduct by financial advisers, that is, to compensate customers according to arrangements negotiated with ASIC while requiring few changes to the business itself.'[3]

At an operational level ingrained cultural forces can distort perceptions within organisations about risk and incentives, especially in the hyper-competitive environment of finance which may adapt ever-increasing matrices of risk as the norm.[4] Moreover, the complexity of modern finance and fragmented chains of command governing the production and dissemination of specialised knowledge increases the information asymmetry risk. Consequently as has been highlighted most painfully in some of this royal commission's public

[1] See: G Gilligan, *Regulating the Financial Services Sector,* (London: Kluwer International, 1999).

[2] G. Hofstede, *Culture's Consequences: International Differences in Work-Related Values*, (1980), 25 (Culture could be defined as the interactive aggregate of common characteristics that influence a human group's response to its environment. Culture determines the identity of a human group in the same way as personality determines the identity of an individual.').

[3] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report, Volume 1*, September 2018, p.82, https://financialservices.royalcommission.gov.au/Pages/interim-report.aspx, (accessed 25 October 2018)

[4] D C Langevoort, 'Chasing the Greased Pig Down Wall Street: A Gatekeeper's Guide to the Psychology, Culture and Ethics of Financial Risk Taking' (2011), 96 *Cornell Law Review*, 1209.

hearings and its Interim Report, scandals, for example, Commonwealth Financial Planning Limited or Storm Financial and egregious practices such as the charging of fees for no service increase the risk that the unscrupulous within the financial sector will take advantage of what the economist David C. Rose has termed the 'golden opportunities' of deception.[5] Reducing these 'golden opportunities' presents as a key goal for this royal commission and the lever of licensing reform can help to achieve this aim.

It is not only unfair, but also dangerous to the financial health of individuals and organisations in Australia that there is an imbalance between the privileged position that participation in the financial sector allows, through the mechanism of the Australian Financial Services Licence (AFSL), (which is after all a gift of accreditation by the state), and what might be termed the civic duties and obligations that accreditation carries with it. In recent decades this balance has shifted too far towards expectation of assuming a licence and the opportunities for reward and sometimes unfortunately excessive remuneration that it brings. This has been compounded not only because of prevailing remuneration arrangements which have been dominated by short term priorities, but also by the broader organisational context within the Australian financial sector. For example, using 2017 data from the Australian Securities and Investments Commission (ASIC) the Productivity Commission reports that just six institutions, the four major banks, AMP and IOOF Holdings have more than 35 per cent of the total population of financial advisers operating under licences that they control.[6] This level of concentration leads to diminished accountability and transparency in relation to the activities of individuals who are selling products or recommending products to consumers. It also becomes less clear where the accountability mechanisms lie within the organisations who are the licence holders for thousands of individual authorised representatives. It is these layers of ambiguity that facilitate the activities of some unscrupulous authorised representatives and permit them to move more easily between financial organisations. This ambiguity can contribute to market participants seeking to explain away widespread dishonest behaviour as *bad apples*, or as in the Commonwealth Bank of Australia (CBA)'s initial submission to this royal commission: '..pockets of poor culture.'.[7]

The situation is expected to improve as the Financial Adviser Standards and Ethics Authority (FASEA) becomes more established in its work and effects.[8] However, financial professionals in Australia should be issued with unique identifying numbers in the same way that they have a licence to drive a vehicle on Australian roads, so that their financial capabilities and record can be monitored in a similar way to their driving history. Individual doctors, electricians, lawyers, indeed many occupational groups have to meet such an obligation in the interest of public safety and protecting Australian citizens. Why should those whose actions impact the

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[5] DC Rose, *The Moral Foundations of Economic Behavior* (New York, Oxford University Press, 2011) 16;

[6] Productivity Commission, *Draft Report: Competition in the Australian Financial System* (January 2018), 572 <https://www.pc.gov.au/inquiries/current/financial-system/draft/financial-system-draft.pdf>, (accessed 25 October 2018).

[7] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report, Volume 1*, September 2018, p.86, https://financialservices.royalcommission.gov.au/Pages/interim-report.aspx, (accessed 25 October 2018). For a critique of how financial organisations can seek to explain away widespread deviant and sometimes illegal behaviour see: G. Gilligan, "Jérôme Kerviel the "Rogue Trader" of Société Générale: Bad Luck, Bad Apple, Bad Tree or Bad Orchard?" (2011), *The Company Lawyer*, Vol.,32, No.12, pp.355-362

[8] See *Financial Adviser Standards and Ethics Authority*, https://www.fasea.gov.au/, (accessed 25 October 2018)

financial health of so many Australians not be subject to similar expectations and mandatory obligations?

Recommendation 1:

This inquiry should make detailed recommendations to Government to ensure that Australia's financial licensing regime is more proactive, accountable and transparent. In particular: i) tighten the licensing requirements so that the licence under which an individual gives financial advice is tied to that individual and their performance history, rather than them being sheltered under the licence of a large institution; and ii) raise substantially the transparency surrounding the activities of those who give financial advice so that financial professionals are more likely to meet their duties not just their interests.

Two themes that have recurred with depressing regularity during this royal commission's rounds of public hearings have been relating to regulatory failures of consumer protection and problems associated with lack of competition. The Interim Report asks whether the response of both ASIC and the Australian Prudential Regulatory Authority (APRA) to misconduct has been appropriate and if not how recurrence of inappropriate response can be prevented.[9] Both ASIC and APRA, (but especially ASIC), have wide regulatory remits. Consequently, when these agencies are constructing their Annual Reports, a vast amount of activity and issues have to be covered in a single report. Consequently, it can be difficult to gauge accurately how these agencies are specifically contributing to improvements in discrete areas such as consumer protection and competition. This uncertainty and lack of regulatory accountability can be improved by placing a mandatory obligation on not only ASIC and APRA, but also all regulatory agencies with responsibility in the financial sector to produce stand-alone annual publicly available reports on these issues. These reports should contain observable empirical criteria by which the effectiveness of regulatory activity upon consumer protection and competition can be measured.

Recommendation 2:

That ALL agencies with regulatory responsibility in the financial sector be required to submit separate reports each year on how their regulatory efforts have improved consumer protection and competition in the Australian financial sector. These reports should contain measurable empirical criteria, be publicly available and submitted to The Treasurer and Parliament, (for example to the Parliamentary Joint Committee on Corporations and Financial Services).

The Australian system of compulsory superannuation contribution has seen the sector experience enormous growth in recent decades. Data from the Association of Superannuation Funds in Australia (ASFA) in June 2018 reveals that superannuation assets in

[9] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report, Volume 1*, September 2018, p.345, https://financialservices.royalcommission.gov.au/Pages/interim-report.aspx, (accessed 25 October 2018).

Australia totalled $2.27 trillion.[10] Deloitte projects that Australia's superannuation system will continue its rapid growth and that by 2035 assets will total $9.5 trillion.[11] This affirms that the strategic importance of the superannuation system to individual Australians and the Australian economy more generally will continue to increase at a rapid rate. This further emphasises the need for strong consumer protection regarding the superannuation sector and Round 5 of this royal commission's hearings explored case studies that cast doubt on whether existing regulatory arrangements are capable of delivering adequate protection to Australian superannuation investors.

Those Round 5 hearings saw a disappointing litany of failure not only by market actors to meet their legal duties and obligations but also meaningful enforcement of existing law by the responsible regulators. These included problems regarding conflicts of interest involving trustees of retail superannuation funds and their interactions with major banks, banks charging customers for services that were not delivered and the charging of fees to dead customers.[12] The case studies in the Round 5 hearings demonstrated that the rights and needs of superannuants are not being sufficiently protected under the current muddled regulatory infrastructures. The scale and strategic importance of the superannuation sector as discussed above are crucial not only to individual Australians but also to the national economy and Australian society itself. Rather than seek to re-assign regulatory responsibility for Australia's superannuation sector between ASIC, APRA and the Australian Competition and Consumer Commission (ACCC) with its attendant problems of regulatory arbitrage, a new regulatory agency should be established with sole responsibility for the whole superannuation sector. The needs of Australian superannuants, the different time horizons associated with superannuation compared to the broader financial sector, the responsibilities of a national government to meet the needs of an ageing population and the goals of the sector itself mean that superannuation could be regulated by a separate dedicated regulatory agency.

Recommendation 3:

That a separate statutory regulatory authority the Australian Superannuation Regulation Commission (ASRC) be established with a specific mandate for the regulation of all aspects of the Australian superannuation sector. The proposed ASRC should have a mandated focus on issues of consumer protection and promotion of competition in the Australian superannuation sector. It should report on an annual basis to The Treasurer and the Australian Parliament.

[10] ASFA, *Superannuation statistics*, https://www.superannuation.asn.au/resources/superannuation-statistics, (accessed 25 October 2018)
[11] Deloitte, *The dynamics of a $9.5 trillion Australian super system*, https://www2.deloitte.com/au/en/pages/media-releases/articles/dynamics-of-9-5-trillion-australian-super-system-171115.html, (accessed 25 October 2018)
[12] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Round 5 Hearings*, https://financialservices.royalcommission.gov.au/public-hearings/Pages/round-5-hearings.aspx (accessed 25 October 2018).