FINANCIAL SERVICES ROYAL COMMISSION INTERIM REPORT SUBMISSION

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Submissions below are referenced (as ***bold italics***) to the Royal Commission's Interim Reports, plus I have addressed some policy issues and general questions that are mentioned in ***Volume 1, Chapter 10*** of the Interim Report.

Many comments relevant to the interim report have already been included in two previous submissions [redacted] It is recommended that these two submissions be reviewed when considering this submission relating to specifics in the interim report.

2 Financial advice

Issues

- ***culture and incentives***

Accountants have been barred from providing financial advice, relinquishing this service to lesser trained financial advisors who, in many instances, have been shown to have a culture of substantially lower ethical standards than the providers of accountancy services.

The point being made is that the legislated standard of qualifications and expertise for financial advisers is much lower than for accountants. That being said however, directors, senior company/bank officers and managers in oversight roles, despite having higher level qualifications and expertise, have also been proved by the Royal Commission to be wanting. Therefore educational standard alone does not prevent misconduct. There should however be a minimum (degree) standard for the providers of financial advice, with a requirement to maintain currency.

- ***conflicts of interest and duty and confusion of roles***

Care should be taken not to minimise the effects of conflict of interest and failure to act in the client's best interest. Mention of "***confusion of roles***", should not in any way excuse misconduct which in effect results in theft of the client's assets for personal gain. Mention is made of "***being vertically integrated***" as a stem cause. Although this reference in the interim report relates to manufacture, sale, plus advising the use and purchase of financial products, there is another aspect of vertical integration not mentioned. In my earlier submission[(1)], financial advice was provided by a company set up by accountants. Many board members were shared between the formative accountancy firms and the licenced financial advice provider. In this particular instance, the accountancy and financial service providers shared common aspects of trading names and logos, to the extent that clients would be excused for thinking that the entities providing services were one and the same, when this was not the case.

The point being made is that the major focus of the Royal Commission has been organisations providing jointly financial products and advice, such as the banks. Because of similar levels of misconduct, other providers of financial advice should not be overlooked by the Royal Commission. The extent of the problem is much wider than identified in the interim reports and caused by overt commissions and kickbacks alone.

- ***regulator effectiveness***

This subject has been covered in a previous submission[2], however I will comment in more detail below in response to specific Royal Commission questions. In my opinion, the current situation would not have developed were it not for the completely ineffectual regulatory system. This includes both government regulatory systems (ASIC and APRA) and particularly self-regulatory organisations (FOS now ACFA). The latter I believe to be acting primarily in the interests of its own membership – representatives of the Australian financial services industry.

- ***issue missing from the interim report – ineffectiveness of the current self-regulatory system***

My experience with FOS (now AFCA) as recounted in an earlier submission[2], indicated to me that the Royal Commission's view of the self-regulatory aspect of the financial service industry, mediated by FOS, would benefit from further investigation of FOS. From reading the interim report the impression is gained that FOS is performing a very useful function, impartially investigating consumer complaints, identifying systemic issues (***Vol 1, P174***), appropriately reporting potentially serious misconduct to ASIC (***Vol 2, P252***), finding wholly or partially in favour of applicants (numerous references) and instructing banks to pay wronged clients. The impression from the interim reports is that the banks, despite being displeased with FOS findings, generally were ultimately compliant (numerous references). My experience[1 and 2] with FOS over an 18 month period, concluding in a determination by a FOS Panel, paints quite the opposite impression of FOS.

The Royal Commission mentions in the interim report (***Vol 1, P334***) that some FOS applicants "***struggled to achieve what they believed to be a satisfactory outcome***" mentioning that "***if those beliefs were unrealistic, it is important to explore why***". In my opinion these sentences indicate a bias which favours FOS. It is the applicant who is "***struggling***", potentially with "***unrealistic beliefs***". While the Royal Commission suggests "***exploration***", the mistaken premise is that exploration should be into the "***reason for the unrealistic beliefs of applicants***", rather than into any FOS misdeed.

What I considered to be a satisfactory FOS outcome was quite realistic, backed by a sound knowledge of legislation, supported by comprehensive documentation, detailed analysis and based on procedural fairness. I therefore contend that it is also important to explore in detail the case already outlined[2], why FOS performed in a way that was absolutely opposite to that portrayed in the Interim Report. While instances of reported entities contravening FOS Terms of Reference (ToR) have been identified i.e. ***Vol 2, P253 and P286***, nowhere in the Royal Commission Interim Report is there a report of FOS contravening its own ToR and Operating Procedures (OP's) to the substantial extent reported in my earlier submission[2] and as I reported in submissions to ASIC. The material I made available to ASIC was extensive. This was partially due to the tactics used by FOS to dissuade and exhaust the applicant, partly due to mis-information provided by the FSP and not challenged by FOS during the complaint process, and partly due the detailed analysis and presentations by the

applicant. My contention is that this particular case if reviewed by the Royal Commission will provide a comprehensive insight into the fatally flawed self-regulatory framework as mediated by FOS. The reason I contend for little adverse material on FOS provided to the Royal Commission would partially be due to applicants being exhausted by the FOS process and having given up.

The early stage of my complaint to FOS was satisfactory, reinforcing my mistaken belief that FOS was an independent and unbiased government entity rather than a body set up by and paid for by the financial industry itself to self-regulate. Having gone through the complete FOS complaint process to the final panel determination and having determined the true nature of FOS, I have formed an opinion of FOS that is completely opposite to that which appears in the Interim report. I therefore question why such a body, embedded as it is within the demonstrably corrupt banking and financial services industry, should appear to be so clean in the Royal Commission's Interim Report. I would be interested to know how many former banking and financial service employees are FOS staff members. The banking and financial services industry is well known for forward planning, particularly when it comes to preservation of their own profits and privileged position. My belief is that, being aware of the revelations that would come through the Royal Commission, the financial industry sought to portray a satisfactory self-regulatory FOS framework in an attempt to preserve this framework. I further believe that in their own submissions, the financial industry sought to convey to the Royal Commission, how well FOS was protecting consumers' interests, by indicating amongst other things, the number of prejudicial FOS findings against themselves.

The only instance of mild criticism of FOS that I can find in the Royal Commission Interim Report is comment regarding the "***inconclusive nature***" of a FOS determination (***Vol 2, P304***).

Issues questions in the ***Financial advice*** section of ***Vol 1, Chapter 10***, on which I wish to make comment are listed below:

How does a financial adviser's employer encourage provision of sound advice (including, where appropriate, telling the client to do nothing)?

How do advice licensees encourage advisers aligned with the licensee to provide sound advice (including, where appropriate, telling the client to do nothing)?
The answers to the two questions above have been combined as the solutions are common. The answer lies in the Royal Commissions own ***Interim Report Volumes, as outlined in the Executive Summary***.

In my opinion the answer is two-fold, meeting the two identified causes, ***greed*** and ***dishonesty***. Comment will be made below with respect to other questions posed by the Royal Commission, but in summary:
Greed: Actions by the financial industry have been based on remuneration of employees and advisers tied to profit to themselves, i.e. the providers. This paradigm needs to change. Remuneration of employees and advisers should be based on profit to the client, plus a base "fee for service". This fee may be indexed, based on the complexity of the service, or the time required by a competent provider to deliver the service. The remuneration should never be calculated as a percentage of the portfolio managed.

The provider of services and products also should also receive a "fee for service", based on the cost of providing that service, with an agreed margin of profit, much as Mutual Societies did of old. Services and products should have no inherent or trailing value to the provider, or the agent, other than through the agreed profit from initially providing, then administering the service. To prevent banks searching "***for their share of the customer's wallet***", it must be made clear that this activity is stealing and is therefore illegal.

Dishonesty: Cases of dishonesty and contravention of law at all levels should be met with the full force available. If the current law does not allow for a sufficient punitive deterrent, then the Royal Commission should recommend penalties that will act as deterrents. These deterrents need to be orders of magnitude greater than the loss suffered by clients and the gains made by the perpetrator. From my own experience, there is no way that FOS should be given the job of reviewing transgressions or administering deterrent penalties. Nor should clients be subjected to expensive litigation proceedings to receive compensation and justice. I believe such a system would be manipulated by those with the biggest pockets and who have the more astute lawyers.

Should any part of the remuneration of financial advisers be dependent on value or volume of sales?

My answer is "*only to the extent of a charge equivalent to retrieval of brokerage costs*", so in terms of personal remuneration for financial advisers my answer is "*no*". See comments above regarding remuneration, where I recommend that remuneration should be based on the profitability of investments to the clients, not based on the value, or volume, of sales. My answer in practice becomes more complex when a way of handling negative returns, or loss in value, is considered. Should the financial adviser have to pay back remuneration when the value of the product falls below the purchase price, or dividends fall? My opinion is that if financial advisers share in the profits of their recommendations, then they should also share in the losses. I expect that nothing will focus an adviser to act in a client's best interest more than if the adviser's best interest is directly linked to their client's best interest.

Linking financial advisers' remunerations to the value of sales encourages bleeding of the capital value of clients' portfolios to advisers, rather than encouraging growth in clients' assets. Linking financial advisers' remuneration to the volume of sales encouraging "churning", where frequent buying and selling results in greater return of fees to financial advisers.

Should all financial advisers (including those who now act as authorised representatives of an advice licensee) be licensed by ASIC?

My short answer is "*yes*". Having had experience with the Financial Planners Association of Australia, I have nothing but contempt for the way this organisation protects their membership at the expense of their members' clients. Not only should ASIC be responsible for licencing of financial advisers, but minimum qualification standards and maintenance of currency should be set. Additionally identification of transgressions, like those identified by the Royal Commission, should result in immediate disqualification to practice.

Unfortunately as ASIC does not have a good reputation so far with regulating Australian Financial Industry licensees, there is no anticipation that ASIC will do any better in licencing and overseeing the much greater number of financial advisers and authorised representatives.

Should the period after which a client must positively review an ongoing fee arrangement be reduced from two years to one?

My answer is "*yes*". There should be annual reviews in which performance can be accessed by the client.

In the previous submissions [1 and 2] it has been stated that FOS found no failing by the FSP and their authorised representative, despite 10 years without any statements of advice. The client was unable to review the ongoing fee arrangement. My question is that if the current interval requirements are being ignored, how will merely reducing the interval, increase adherence? There needs to be an enforcement structure as well.

Should platform operators be permitted to deduct fees on behalf of licensees without the express authority of the client of the platform operator?

My short answer is "*no*". The situation however is much more complex. The BT platform statement with which I have experience is almost impossible to understand. It is not clear how much and to whom payments are being made. As there is no single collated figure for fees, clients are forced to work this out for themselves. Very few would be capable of doing so. Even those capable, like myself, had great difficulty interpreting the statement.

The FSP that was reported in my previous submissions[1 and 2], seems to correct the FOS Panel, because of the FSP's claim that the panel misread the BT statements. If it is true that even a FOS Panel did not understand the platform operator's statement, that what chance is there for the average client to understand statements? Sadly the FOS Panel accepted the FSP's interpretation of the platform operator's statement without further question, despite my opinion that the FSP's interpretation was incorrect and misleading.

Platform operator's statements need to be reviewed to improve transparency and clients' understanding.

When an employee or authorised representative is terminated for fraud or other misconduct, should a licensee inform their clients of the reason for termination?

When an employee or authorised representative is terminated for fraud or other misconduct, should a licensee review all the files or clients of that employee or intermediary for incidents of misconduct?

These questions are similar and my short answer to both is "yes". I expect that clients have had enough of being kept in the dark, so want to know what is really going on. Fraud and/or misconduct is unlikely to have been perpetrated on one client only. Discovery of one case is amazing because, as the Royal Commission has identified, licensees are more inclined to hide illegal activity, rather than investigate its extent. The reason for this behaviour is due to the inclination of licensees to limit

their own liability, which in itself is also fraudulent and if not illegal, it should be. In addition, there should be clear provisions for the clients to be adequately compensated for loss caused.

Should negotiation and settlement be the main approach for a regulator?

Negotiation and settlement should be the first approach of the regulator, not the main approach. Strict allowable time limits should be placed on the FSP's response to the regulator's inquiry. If response is not satisfactory or there is excessive delay, then legal proceedings should be commended.

Should there be greater focus on general deterrence in regulatory strategy?

"Yes", but not just general deterrence, but enforcement. FSP's currently place little heed to the powers of the regulators for there has been rare intervention, enforcement or imposition of deterrents that are currently available to the regulators. Once there is company and personal liability for breaking the law, FSP's, their employees and Board members will smarten their game and will suddenly see virtue in behaving ethically.

Should a component of enforceable undertakings be the acknowledgment of specific wrongs?

"*Yes*", without more than a "*slap on the wrist*" accompanied by no admission of wrong, organisations will not realise the seriousness of their actions. The current attitude is "*we didn't really do anything wrong, as there was no admission, or legal proceedings. Besides, all we have to do is pay a minor amount and it all goes away*". Enforcing acknowledgement of specific wrongs increases the importance of these wrongs and additionally lets clients know which organisations are not doing the right thing. A bit like accommodation reviews, bad reviews will move clients away from financial institutions who have sloppy governance procedures, or poor ethics. Such reporting provided the impetus for improvement.

Should self-reported breaches of the Corporations Act generally attract legal sanctions unless some special circumstances exist?

"*No, not generally*", I believe that there should be encouragement to self-report breaches as soon as they are identified. Corporations should be encouraged where they identify a breach and put in place procedures to rectify the cause. If however the corporation unduly delays self-reporting the breach, or only reports when the breach is identified by whistle-blowers, or otherwise, this dispensation should not be allowed.

Should banning orders continue to be preferred to civil penalty proceedings in case of licensee/adviser misconduct?

"*No, both should be enacted*". Misconduct which results in banning orders may prevent the licensee/adviser from working in the industry going forward, but there is no penalty for past conduct. Civil penalties should be pursued and include compensation to clients for loss. My question is how often in the past have banning orders been enforced? How many licensees/advisors find a way around the banning orders i.e. by forming a new company, or continuing to operate under a new name? How many licensees/advisers have been let off with minor ,or no penalty? Strict enforcement is the key.

Should ASIC make more use of its Section 916G power to give a licensee information about a person who is or will be a representative of the licensee?

Does Section 916G need to be amended so as to be more effective?

These two questions have been combined as they are both about Section 916G. *"Yes to both questions"*. I have a few questions of my own which if answered unsatisfactorily should be rectified through amendments of the Act. Section 916G puts the onus on ASIC to provide information about a person to the licensee. My recommendation is that all licensees should first approach ASIC to vet their representatives. Otherwise how would ASIC know, or suspect, that the *"person"* is going to be employed? See my answer to the earlier question on this subject regarding ASIC registration of financial advisers and representatives. I cannot see what information needs to be provided as allowed by Section 916G – the particular information, or type of information, should be specified. Let's say that the information ASIC provides is not complementary to the *"person"*, what happens then? Is it left up to the licensee to decide on the suitability of the "person"? This does not sound very satisfactory at all as many licensees have not had a very good record in respect of employing ethical "persons". This is probably because it is the unethical persons are those who produce the most profit.

Should there be more focus on criminal proceedings against licensees rather than individual advisers?

"No, both need to be held liable". Criminal proceedings and penalties need to be imposed which are commensurate with the loss and injury caused to the elderly and most vulnerable of our society.

3 Small and medium enterprises

3.3 External dispute resolution

Should AFCA adopt FOS's approach of putting the borrower back in the position they would be in if the loan had not been made, but not awarding compensation for losses or harm caused?

This question should also be a part of the section on Financial Advice (***2***).

I do not agree that there should be no compensation for losses or harm. Otherwise what encouragement is there for financial institutions and licensees to prevent loss of harm? If there is no penalty there will be no reason to change current practices.

See my earlier comments about FOS. I really encourage the Royal Commission to explore in detail my experiences with FOS[1 and 2]. I will provide my detailed review of this experience (previously provided to ASIC). My expectation is that the Royal commission will form a totally different view of the way FOS operates to that which it currently holds.

6 Regulation and the regulators

Is the law governing financial services entities and their conduct too complicated?
– Does it impede effective conduct risk management?
– Does it impede effective regulatory enforcement?
"No the law governing financial service entities and their conduct is not too complicated". The truth is that the law has been ignored with impunity because ASIC has not enforced the laws, or taken available legal action. Instead ASIC has abrogated its responsibilities to self-regulatory organisations like FOS. Even with clear evidence that FOS was not adhering to its Terms of Reference or Operating Procedures, ASIC has not acted. This is because of an apparent agreement of ASIC with the financial industry not to interfere with FOS.

Should there be annual reviews of the regulators' performance against their mandates?
"Yes".

Is ASIC's remit too large?
– If it were to be reduced, who would take over those parts of the remit that are detached?
– Why would detachment be better?
"No, ASIC's remit is not too large". ASIC needs to be given the funding to fulfil its function. Detachment would not be better, as more problems would result, not the least due to additional impediments of cross-organisational communications (between ASIC and the other organisation) and lower efficiencies due the other organisation development of a separate administration.

What is important is the need for ASIC to be directed to realise the importance of what it now sees as small issues. ASIC has involved itself in the fewer, larger and more acute cases i.e. Storm Financial. In these cases fewer clients have lost everything. While the acute cases are serious, ASIC is missing the systemic chronic cases where substantially more clients have been kept barely financially viable by unscrupulous financial advisors, authorised representatives and the licensees themselves. While ASIC says it can only investigate "systemic cases", they really mean "large systemic cases". If one was the do the sums ie multiply the number of cases by the average loss, I have no doubt that the gross loss to clients from chronic cases would exceed the gross loss from acute cases by many orders of magnitude. While there may be some merit in ASIC going after the "low hanging fruit", unscrupulous financial service providers are using the loophole above to cause loss and harm to a massive number of elderly and most vulnerable of Australia's society.

Is the regulatory regime too complex? Should there be radical simplification of the regulatory regime?
"No, the regulatory regime is not too complex, just underfunded which is preventing enforcement".

Should industry codes relating to the provision of financial services, such as the 2019 Banking Code of Practice, be recognised and applied by legislation like Part IVB of the Competition and Consumer Act 2010 (Cth)?
It is very difficult to legislate aspirational Codes of Practice in their entirety. Separate the aspirational components which will be kept in the Code of Practice, from the necessary and minimal legislative requirements and enshrine the latter in legislation. Encourage banks to advertise their

degree of adherence to the Code of Practice. The degree of adherence should be determined by an independent authority can award a code of practice adherence ranking.

Are ASIC's enforcement practices satisfactory? If not, how should they be changed?
ASIC's enforcement practices are pitiful and totally inadequate. See comments above about ASIC following up on few acute cases but ignoring the many more chronic cases. Change ASIC practices through giving it funding to use its teeth.

If the recommendations of the Enforcement Review are implemented, will ASIC have enough and appropriate regulatory tools?
I believe ASIC has the tools, but does not have the resources, due to insufficient funding. Penalties should be reviewed to act as a real deterrent.

Should ASIC's enforcement priorities change? In particular, if there is a reasonable prospect of proving contravention, should ASIC institute proceedings unless it determines that it is in the public interest not to do so?
"Yes, ASIC's enforcement practices should change". Proceedings should be instituted if there is reasonable prospect of proving contravention. Reviewed (much larger) penalties should be imposed which will act as a real deterrent which will increase the risk to corporations from being caught. Corporations will incorporate the increased penalties and likelihood of being caught in their risk calculations when considering engaging in illegal activity, or being complacent about lax governance. The natural result will be a decrease in corporation sanctioned illegal activity and improved governance.

My experience is that currently FSP's have absolutely no concern about ASIC as they believe they can act with impunity and ASIC will do nothing. [redacted]

7 Entities: Causes of misconduct

7.1 Conduct risk

In the section below, mention is only made about banks. This excludes the arguably much larger sector of the financial services industry, in particular companies providing financial advice and the self-regulatory (FOS) sectors. My comments below refer to all financial service sectors.

What are banks doing to meet the danger of conduct risk?
For members of the financial services sector, "risk" means "risk to themselves", not "risk to their clients". Currently the financial services sector does everything to protect themselves and their profits, at the expense of their clients. This is not to say that banks and other financial sector organisations should not be profitable. Without profit and growth, this sector will risk bankruptcy. What is needed is a consumers' advocate and greater alignment of corporation and consumer risk, so that the financial services industry takes into consideration, risk to their customers as well, when making decision.

What are regulators doing to meet it?
In two words, "*very little*".

What can banks do? What can regulators do?

What should either or both be doing?
The above two questions are combined. The financial industries sector and regulators need to work together. Historically the financial industry sector will pay heed only to their own interests. Therefore regulators need to represent a fair balance between clients' interests and those of the financial services industry. The fair balance mentioned above needs to be in the national interest.

7.2 Remuneration

As for the section above, my response applies to all financial services industry sectors.

Should any bank employee dealing with a customer be rewarded (whether by commission or as part of an incentive remuneration scheme) for selling the client a product of the employer? That is, should any 'customer facing employee' be paid variable remuneration?
Remuneration should be related to customer outcomes, not incentive, volume of sales based.

If the answer is either 'no' or 'some should not' what follows about incentive remuneration for managers or more senior executives? If more junior employees should not be remunerated in this way, why should their managers and senior executives?
As for their juniors, managers and more senior executives should be remunerated based on customer outcomes. This means that all employees should be permitted to provide the best product for their clients, even if this is not their employer's product.

Should other changes be made to the remuneration practices of banks? What would they be, and how could change be required?
See responses to the two answers above.

7.4 Intermediaries

As for the sections above, my response applies to all financial services industry sectors.

Is it desirable to prescribe that some or all of those who are not employees of banks, but deal with bank customers, must act in the interests, or the best interests, of the client?
It is not just desirable, but essential that all members of the financial services industry dealing with customers be mandated that they "*must act in the best interests of the client*".

There needs to be a way to track that the best interests of the customer are being met.

How is a value based commission consistent with acting in the interests, or best interests, of the client?
A value based commission is not at all related to acting in the best interests of the client. I would like to comment on the wording of "client's interest" versus the "client's best interest". The

intermediary and all others need to act in the best interest of the client. If an arrangement is put in place that results in the client making a minuscule profit, while the financial service provider makes a hefty profit, the requirement to act in the client's interest is met. On the other hand, acting in the client's best interests means that if there is a hefty profit to be made, it goes to the client. The degree of financial services profit will depend on their skill in selecting higher performing, stable products which relate to their client's risk profile. Care must be taken not to introduce "*weasel words*" which can mean nothing, or anything. Use language that is clear and unambiguous.

Commissions which have an appropriate upper limit, need to be linked to benefit to the client.

Should intermediaries be subject to rules generally similar to the conflicted remuneration prohibitions applying to the provision of financial advice?
"*Yes*".

If some or all intermediaries should owe the customer a duty to act in that customer's interests, or best interests, is it enough to prescribe the duty and direct 'management' of conflicts between interest and duty?
Duty needs to be prescribed and management of conflicts between interest and duty needs to be directed, but this is not enough. The ultimate criterion is the performance of products supplied to customers and this needs to be monitored, with appropriate action when performance falls below what is acceptable in relation to average market performance.

Matters missing from the Royal Commission's interim report

The findings of the Royal Commission will come as no surprise to the majority of the Australian community. I have no doubt that in its final report the Royal Commission will make many valuable recommendations, which if implemented in their entirety, will go a long way to reducing the largess of the Australian Financial Services Industry into the future.

The question that most will ask is – "*What about past wrongs and losses?*"

So what will the Royal Commission recommend for past and future cases?

My advice is the following with regards to Australian Financial Services:

- Where there is clear evidence of illegal activity including fraud, misconduct, or deliberate acts in contravention of Australia's laws, that the Royal Commission recommends to the appropriate authorities that these corporations, companies and individuals be prosecuted to the full extent of the law. This recommendation should include not only the imposition of fines, but also confiscation of assets gained by illegal activities, as allowed by law.
- Establishment of a government funded instrumentality which will investigate and prosecute cases that the Royal Commission has identified, with the view to obtaining adequate compensation for loss and suffering caused by fraud, misconduct and other illegal activities, from those responsible for these activities.
- That the above body further investigate other submissions put before the Royal commission, but which the Royal commission has not had the resources, or time, to investigate fully. As above, this instrumentality works to obtaining adequate compensation for loss and suffering caused by fraud, misconduct and other illegal activities, from those responsible for these activities.
- The government funded instrumentality, will be available to investigate similar future cases and work to obtaining adequate compensation for loss and suffering caused by fraud, misconduct and other illegal activities, from those responsible for these activities.
- The government funded instrumentality should not be FOS (now ACFA). After further detailed investigation of FOS, as recommended in this submission, that the Royal Commission recommends disbandment of FOS (now ACFA).

I offer my thanks for the opportunity to contribute to the important work of the Royal Commission.