Amstelveen

Amstelveen Pty Ltd
ABN: 54 615 045 531
Level 1, 204 Clarence St
Sydney NSW 2000

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The Hon Kenneth Hayne AC QC
Royal Commission into Misconduct in the Banking,
Superannuation and Financial Services Industry

By email: FSRCenquiries@royalcommission.gov.au

Dear Commissioner,

Re: Response to Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Interim Report

Amstelveen welcomes the opportunity to respond to the Interim Report (the report) of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Commission).

We note that the Commission has identified a series of issues on which it seeks input. In this submission we have identified three areas which we believe are worthy of particular consideration by the Commission in its Final Report. These include:

- The complex nature of financial services regulation, and the need for simpler, principles-based regulation;
- The need to determine which community expectations of financial institutions are reasonably held, and which do not give due consideration to the commercial nature of institutions; and
- Support for existing approaches to enforcement used by regulators, against the Commission's suggestion that regulatory outcomes may be best achieved through more frequent prosecution.

We describe these considerations in further detail below.

1. Regulatory complexity

The report acknowledges the existing complexity of financial services regulation. It raises a regulatory paradox; that creating more regulation may actually work against intended regulatory outcomes. The report notes "legislative complexity can lead to difficulties in supervision and enforcement. It can cause the regulated community to lose sight of what the law is intending to achieve and instead see the law as no more than a series of hurdles to be jumped or compliance boxes to be ticked". We agree with this position; a rules-based approach can lead to a situation in which the intent and spirit of the regulation is obscured.

The report also seems to suggest that regulators have been insufficiently proactive in addressing issues of misconduct. This may be viewed as the case, for example, in the instance of conflicted remuneration in the provision of financial advice. Past instances were noted in which financial advisors may have been biasing the products of their own organisations when recommending products to customers. The Freedom of Financial Advice (FoFA) reforms were subsequently introduced, which created a duty for advisors to act in the best interests of their customers, and a ban on conflicted remuneration structures, among other provisions. While this could be viewed as reactive, in reality institutions will take advantage of commercial opportunities as they arise, and regulation will respond to those innovations. It is unreasonable to expect regulators to be able to identify commercial opportunities before the commercial institutions that they enforce.

Regulations are best future-proofed against institutional activities if they are principles-based and address intent, rather than defining rules. The FoFA best interests duty described above is a good example of principles-based regulation, as it legislates an intent; i.e. customers should receiving advice which is in their best interest. Existing rules-based legislation, such as those which require advisors to assemble detailed statements of advice, were well intended but failed to achieve the regulatory intent which this new duty does.

We believe that the Commission should propose a consolidation and simplification of financial services regulation, predicated on principles and intent, rather than specific rules and procedures.

2. Community expectations

The Letters Patent establishing the Commission asks it to determine "whether any conduct, practices, behaviour or business activities by financial services entities fall below community standards and expectations". In a number of areas, the interim report concludes that institutions did not meet community expectations with regard to the provision of products and services.

The Commission rightly identifies that all commercial organisations have an element of a profit motive. However, the report makes a series of references to institutions having pursued profit over the interests of customers, and at times seems to imply that an institution should always place community expectations above the interests of the institution.

While the Commission has identified instances in which institutions have not met community expectations, it would be sensible to determine which of those expectations are reasonably held, and in

which instances it is acceptable to place an institution's interests above individual customers. This would set a more useful benchmark of expected conduct than the broad brief of 'community expectations'. As an example, the community appears to expect that banks will apply an additional level of lenience in loan arrears involving agricultural businesses. Is this community expectation reasonably held; or is an institution right to treat farmers the same as other customers?

If the Commission ends up looking only at community expectations, it will fail to identify recommendations which are relevant to the operating realities of our financial services system. If institutions always put community expectations above their basic responsibility to provide income for shareholders, they will cease to exist as corporations.

We recommend that the Commission further examines community expectations of the financial services industry, and the extent to which they are reasonable. Conversely, the Commission should identify those community expectations which conflict with the inherently commercial nature of financial services entities.

3. Accountability and enforcement

The interim report inventories all instances in which it believes that in-scope organisations may have breached community expectations, or in which conduct breached applicable laws. It is worth noting, though, that humans are fallible, and mistakes will be made in any process and in any organisation. Except in extreme instances, the report does not separate unconscionable conduct from honest mistakes. It would be helpful if the Commission discerned between simple, isolated mistakes, and ill-intent.

The Commission also appears to believe that regulators use non-litigious avenues of resolution too frequently, such as Enforceable Undertakings (EUs). The report asserts that regulators should have a bias for pursuing prosecution, where an identified breach of law has occurred. The public nature of court proceedings is also identified as promoting better behaviours.

This, however, may be a simplistic way to look at regulatory remedies. Litigation is slow and expensive. Often, the issue of misconduct is open to interpretation, and regulators need to consider that a failed prosecution may set a disadvantageous legal precedent. The report identifies that this can prompt a change of law, however regulators cannot rely on this eventuality. Meanwhile, if regulators are simply responsible for applying prescriptive rules, this will discourage regulated institutions and individuals from collaborating effectively with those regulators.

We believe that the current model of regulatory enforcement is appropriate. While the quantity of issues inventoried in the interim report appears large, major issues had previously been identified and were being addressed. EUs have been used successfully to drive remediation of many of these issues and the details of these are already publicly available.

We recommend that the Commission is conservative in prompting changes to the current enforcement model, and that further consideration should be applied to the role of intent when considering any changes to the penalty regime.

We hope that the identified considerations are useful as you form your final report. We would welcome the opportunity to discuss these in further detail at any time in the future.

Sincerely,

[redacted]

David van Gogh
Director
Phone: [redacted]
Email: [redacted]

[redacted]

Wendy Valent
Manager
Phone: [redacted]
Email: [redacted]

[redacted]

Hiral Patel
Manager
Phone: [redacted]
Email: [redacted]

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ABN: 54 615 045 531
Level 1, 204 Clarence Street
Sydney NSW 2000
http://www.amstelveen.com.au