A Response to Volume 1 of the Interim Report of the Royal Commission on Financial Services

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Introduction

This submission is a response to the interim report. It makes some comments and attempts to come up with suggestions of how to address the problems identified by the report.

As stated in my previous submission, I have some experience in the consumer experience of dealing with the insurance industry's response to claims. Most work done on insurance deals with inappropriate policy sales and commissions and as such this is similar to banks in terms of the power relationship with customers and the use of commissions and commission agents of divided loyalties. As such I would like the Commission to look further at this aspect of insurance, but would offer what I can about banks.

There is a suggestion to create an Ombudsman's office to deal with consumer complaints and to empower consumers both at an individual level to be certain that they get a fair deal and at a more macroscopic level to collect data about the overall situation in the industry.

Summary and Recommendations

1. Banking and insurance should be seen as social necessities, not merely as 'for profit' entities. This priority should be maintained in all government dealing with them, and at least some of their capital reserves should be used for public good.
2. The current 'top-down' regulation system has spectacularly failed and corporate behaviour in the banking, insurance and financial sector is ethically at a low ebb.
3. The lack of credibility in the regulation of powerful interest is a major element in the public perception that laws do not exist for powerful groups. This is undermining social trust in both the government and the legal system.
4. The key philosophy for regulating in the consumer interest is that it must be empowering for consumers to address the power imbalance between them and corporate interests and it must be 'bottom-up'.
5. There is need for independent data collection to monitor the actions of the banking, insurance and financial services industries in Australia.
6. There is a need that there be a grass roots mechanism for the identification and initiation of action on malfeasance in these industries.
7. The roles of registration of consumer complaints, the processing and if necessary amplification of them, and the compilation of data about financial providers and their regulators could be provided by a Financial Service Ombudsman.
8. Collected statistics from the Ombudsman must be processed to allow the public to compare the performance of banks, insurers and financial service providers. They must also allow the public to judge the effectiveness of the regulators in simple terms such as the percentage of complaints resolved to the satisfaction of complainants.

9. The Financial Industry Ombudsman must be protected from political or industry interference. As such:
    a. It must be financed from general revenue and not from a levy from banks or insurers.
    b. The Minister responsible must be different from the one who oversees the industries regulated.
10. Financial Services are an industry and must be regulated at both an industry level and by registration of individual practitioners.
11. Self-regulation is no substitute for legislation and must not be allowed to become so. The legal framework should be simple and based on principles of ethics and fairness. Self-regulatory codes may be tolerated in so far as they clearly define what ethical behaviour is.
12. There must be changes in housing policy to reduce the preeminent and protected place of housing in most people's financial system. This has allowed banks to use real estate as the primary securitisation of small business loans which has reduced the ability of banks to assess business proposals on their merits and undermined what should be a sensible credit audit in the client's and the public interest.
13. There must be limits on powerful corporations' ability to destroy lives in their pursuit of lost monies. The ability of normal citizens to pursue loans should be the benchmark in the regulation of this. As part of this the ability of small businesses to pursue monies owed by large corporations must be strengthened.
14. Banks and insurers should have their powers to change terms and conditions unilaterally limited and appealable through the Financial Services Ombudsman.
15. Agricultural lending has higher risk and should be thought of as a hybrid product of banking and insurance as banks take a higher share of the risk.
16. The government should establish a realistic national valuation system for land similar to the New Zealand QV (Queen's Valuation) system, which is widely quoted in real estate transactions. This may give a more reliable benchmark in times of rural stress.
17. Banks should have to justify the level of penalty interest rates in 'distressed' loans to an auditor from the regulator.
18. Insurers must be jointly responsible for the sale of their products (such as funeral Insurance to indigenous youth) even if these are sold through intermediaries.
19. Penalties and restitutions must be at a level that actually deters future unethical behavioiur.
20. The Federal Government should establish:
    a. A government owned bank for basic services modelled on Kiwibank in NZ.
    b. A government owned National Disaster Fund modelled on NZ EQC to deal with major catastrophes.
    c. Publicly owned insurance options in niche markets such as NSW Workers Compensation and CTP to prevent supernormal profits.
    d. A network of financial counselling services for people in crises and this should be well publicised particularly and compulsorily at all gaming venues.
21. Intermediaries who do commission sales should be regulated and the ultimate vendors must be jointly liable for their actions.

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General Points

1. **The Banking Sector**: The Australian banking sector is strong, as was acknowledged in the GFC because of their privileged position, oligopoly market and government guarantee. Continually rising house prices due to tax incentives for property speculation have helped their bottom lines immensely as their asset stock keep rising in price. The determination of ordinary Australian to own their own homes has helped this also. Government self-congratulation on the security of the system is unsurprising but probably not warranted in the circumstances.
2. **The Need for Systematic Data Collection**; The technique of examining case studies as used by the Commission allows the institutions to pretend that these are relatively isolated cases. As more cases come to light their argument becomes increasingly lame and decreasingly credible, but in the absence of hard data to the contrary wins the day in practice. A comprehensive examination of all cases or even a statistically significant survey is not carried out. Nor is a comprehensive data capture measure set up to look at the situation systematically in the future.
   In commerce many individuals at the lower end of the financial scale have stories of mistreatment or injustice, but these are never collated into an overall picture, and regulators at the top appear blissfully or conveniently unaware of the real situation.
   The scientific community recognises the mathematical reality that a large sample size is needed to analyse the probability of a postulate and that many examples must be collected systematically to get evidence and come to conclusions with quantifiable levels of certainty. The legal profession and largely by default the political process has no such rigor, so postulates such as 'Insurers/banks regularly rip off their customers' cannot be tested quantitatively.
3. **Systemic Subcultural Ignorance**: The legal system uses an adversarial system which is, in essence, a debate with the winner having their conclusion implemented. 'There is no truth, there is only evidence' seems to be the mantra. Courts and inquiries ask for evidence which is from individuals who supposedly have knowledge or expertise which they cite with competing credibility to achieve a verdict, decision or policy.
   Even though the subjects of Parliamentary and judicial inquiries remain very similar over time, no prospective study or data gathering measures are set up. Those legally rather than scientifically trained regard this situation as the norm and it continues by default. Scientists my shake their heads at the primitiveness of the decision-making process but they do not campaign actively to change the situation. After all, campaigning is not their profession, and it has always been like this, like an unfortunate element in the environment. Effectively a collective subcultural ignorance in a powerful cluster of professions sets a norm for poor decision making at society's macroscopic level.
   It is probably not reasonable to accuse the legal profession of not being concerned with the truth, but it is reasonable to state that their lack of awareness of, or respect for the systematic collection of data seriously undermines their ability to make good decisions in the interest of justice, particularly when the situation requires an inductive process rather than a deductive one. (Deduction is reasoning from general facts to a particular case; induction is concluding a general situation from a particular case).

This problem is manifest in the regulation of banks, insurers and similar organisation which have the power to set societal norms and the society having poorly developed, cumbersome, financially constrained or captured regulatory mechanisms. These are macroscopic regulators without macroscopic data and with no ability to collect small cases as cumulative anecdotes either.

4. **The Problem and an Answer**: The answer for a regulatory mechanism is twofold;
   a. Set up a regulatory data capture system that allows outside scrutiny of the functions of large institutions and
   b. Allow individuals with problems to have an accessible mechanism to redress the huge power imbalance that exists between them and the institutions.

   This complaints mechanism, set up as an Ombudsman's office would record complaints, which might be thought of as 'alleged suboptimal behaviour' to collect them as neutral data. This would be forwarded to the institution for reply or action. This would initially be a bureaucratic response. If there were no mutually agreed outcome there could be a bureaucratic assessment. But the key would be that it would allow the systematic collection of data and be a first filter step in a hierarchical series of appeal mechanisms which would allow some redress of the power asymmetry between institutions and individuals. The effect of this, in time, would be a modification of the behaviour of such institutions in a way that the current regulatory regime has clearly failed to do, as is amply documented in the analysis of the Sedgwick Report and its aftermath in this interim report.

5. **Inadequacy of existing data collection**: With regards to this an in terms of collecting evidence of misdemeanors, Commissioner Haynes stated that the banks had answered his initial 2/2/18 inquiry with statistical analyses of risks of bad behaviour that they had had trouble collecting! (3 Initial Inquiries pages 8-9). There was no mention of specific cases. It is significant that the regulator was unable to do likewise. No statistics and no cases?! The banks must have had some real cases but chose not to specify them- why precipitate action in the real world? Commissioner Haynes made the point that the NAB said that it would take a long time to collate the cases and it was unable to state how much it had broken the law.

   Given the lack of external governance later shown, one might comment that its lack of attention to this was quite understandable.
6. **Collecting Cases from which to Induce**: The Commissioner stated (5 Proceeding by Case Study page 12) that he had chosen to investigate the cases that were likely to permit identification and useful explanation of issues having a wider application than the particular case. This is an inductive process of reasoning. The cases are what would be called in medicine 'signal cases' in that they draw attention to a situation. But this is a judgement call. Commissioner Haynes is using his experience. In an ideal world, there would be quantitative data about how frequent these types of cases are, but as stated above this requires a data collection system that did not exist with the banks and most certainly not with the regulators.
7. **Trivial Payouts- A Response to No Data?** The report states (4.1 Magnitude and Prevalence page 35-36) that certain amounts have been paid out by Banks and Home loans ($250 million 1/7/10-28/2/18- ASIC figures), Car loans ($90 million with $5.7 million in civil

penalties in same period) , credit cards ($11 million in remediation and $1.5 million in civil penalties) and $127 million in add-on insurance and $239 million for 'processing errors', but this was not related to either total turnover or total profits. It would seem that the restitutive payouts are trivial in magnitude.

8. **'Fess Up!'** It is frankly pathetic that the Royal Commissioner has to judge (4.3 How widespread? Page 38) the prevalence of bank misdemeanors from their own submissions. What does this say about the regulatory framework? That it has not got a clue? Do we run policing by asking unarrested crime bosses how much illegal drugs they have imported or burglaries that they have organised? This speaks volumes about the approach to corporate law enforcement. It is like 'They are all nice chaps and would not do anything wrong'. We need laws for the top end of town as well as for the bottom and these need enforcement or Parliament is little better than a soap opera.
9. **An Opaque System**: With regard to section 7. The availability of financial advice help is not at all well known. Most people have never heard of the 'Financial Rights Legal Centre'. Yet as a doctor I have many patients with financial issues that are critical for them, many created by the niggardly (and in my opinion fraudulent) actions of insurance companies. Most people have no idea where to go for help and rack up huge credit card debts and even get osteoporosis and bad teeth from poor diets and lack of dental work. What is needed is a 'One stop Shop' that helps clients/consumers/customers as corporate entities play with their lives and regulators fiddle.
10. **Sales Drives and housing prices**: It is to be expected that commission agents who make money by selling loans will act in their interests rather than the customer. It would protect consumers not to allow loans where repayments exceed a certain percentage of income and to enforce these, but one would expect that a 'prudent and diligent' banker would do this anyway, and over-prescriptive regulation may do more harm than good. It might be noted that the desperation of people to get home loans is caused by the expectation of continuing price inflation, which is largely due to the tax treatment of residential property resulting in price rises hugely in excess of inflation. The lack of an affordable housing policy has compounded this, and of course the banks have been huge beneficiaries of the real estate price inflation. This may be considered as beyond the scope of this inquiry, but the immense windfall that banks have had from this gives scope for regulators to take firm action without significant risk of serious damage to banks' stability.
11. **The use of intermediaries** (8. Issues that have emerged page 70) is to be discouraged as a general principle. They add a layer of costs and their interests will always be separate from the consumer.
12. **Need for standard Products:** What is needed is that information about financial products be provided in a consistent form so that the much-touted benefits of competition can be realised. It is part of the role of government to ensure that the market works properly by having a regulatory framework. (A 'free market' where the big fish eat the small and the sharks rip off the little people is not in the interests of the society as a whole, but looks suspiciously like what is happening at present). With common products such as home loans, credit cards, car loans or insurance products a basic product should be defined with simple and fair terms and those who want to sell these would put in a quote or rates appropriately.

This would form the benchmark for this type of product. Those who want to vary it can spruik the merits of their variation.

13. **Creation of Standard Products:** The origin of these standard products could be negotiated by consensus of the relevant industry and consumer groups under the aegis of the regulator or even a Department of Consumer Affairs. It would not need to be imposed on the market. But the consumer would have a basic product and could compare prices. The regulator could ensure that those who offered it would meet their contractual obligations. Litigation would also be simpler as precedents would be directly applicable. As it is the complexity and opacity of variable products makes comparisons difficult and the consumer is disadvantaged even before the institutions appear to vary the terms at their will. As stated above when there were simplified contracts, it would be easier for an Ombudsman's office to collect complaints, to refer them to the entities for restitution and reply, to give an initial and appealable judgement and to collect information for more macroscopic actions by regulators such as ASIC.
14. **Costs of the Ombudsman's Office:** Concerns about cost need to be considered. While there is always the reaction that this bureaucracy is an extra cost on the institutions in responding and in the cost of the regulator, which would presumably paid as a levy to the government from the institutions, it is nevertheless probably necessary. An industry having low costs such that there is no scrutiny is likely to turn this lack of costs and lack of scrutiny into supernormal profits rather than a better service for consumers. This would appear to be what has been happening. It may also be a good idea for all loans to be registered. This would presumably be an easy data transfer to the regulatory agency and would give a base line number against which the percentage of complaints could be measured. It would also save money in data collection. In terms of the concerns about privacy, it would need to be questioned as to whether the fact most data on loans, customers and defaults is already available to credit reference agencies and having another player who might act in consumers' interests is likely to be harmful to their interests.
15. **Use of Collected Data:** Statistics collected by the Ombudsman's office could be used to give public feedback on the performance of financial entities. At present consumers have no hard data on which to base their purchasing decisions. If the government is serious about competition providing benefits to consumers, it should support this. The only reason for opposing it would be that it might offend powerful interests.
16. **Protection of the Vulnerable:** There are people who do not read or may not understand financial statements, so there is a public policy advantage in having good financial advice available. As part of this, it would be good to ban advertising or practices that are likely to lead to unwise financial decisions such as gambling advertising and these should be actively discouraged at a policy level as part of improving national financial planning.
17. **The Monitoring Role:** If, however there were an Ombudsman actively monitoring and in consequence discouraging exploitative financial behaviours, it would create an environment where consumer rip-offs were less prevalent. Entities or individuals who ripped people off would be identified and sanctioned. This would be far better than merely having a self-regulatory body impose minimal and unpublicised sanctions. Self-regulatory bodies are by definition dependent on membership for their funding and

have little more sanction than to expel a member which is against their financial interest so tends to be a cosmetic and short-term change of little real consequence.
Platform fees tend to be a 'set and forget' payment system with payment for advice often a percentage of the finds under management and the amount of attention from the advisor may decline with time. The monitoring of this may be difficult, but similar complaints would trickle in and allow a pattern to be ascertained.
If a bad individual or major anomaly is discovered by the Ombudsman this might be notified to other holders of the same product. This were gross there might be many examples this might be obvious, but if more subtle its identification would be dependent on the Ombudsman having a comprehensive database of these types of products and not merely data on complaints which is (hopefully) likely to be much smaller.
No doubt this type of monitoring will be vigorously opposed by those with power in the sector who do not want their power challenged. Those of an ideological 'laissez-faire' persuasion will also oppose it, but it needs to advocated by the Royal Commission as existing regulatory methods are proven failures, and unlikely to change significantly using the same methods. The media is also likely to amplify the change if they have some information to work with.
To address the issue of inappropriate advice: (9. page 137) it must be noted that while it is difficult to legislate against incompetence the above supervision regime above would be able to identify complaints about advice which favours the licensee or commission agent.

18. **'Bottom-Up' not 'Top-Down'**: The key point is that financial reform must come from the bottom up, not from the top down. As is stated in Causes (9.1 page 137) the FoFA reforms' 'legislative provisions emphasise process rather than outcome'. I note that they made a lot more paperwork for financial advisors and meant that smaller funds were no longer allowed to self-manage. It is not certain whether this helped the consumer or merely the larger funds, as this Royal Commission has still been necessary and has shown that bad behaviour is still very prevalent. A 'bottom up' would probably have achieved a better result.
19. **A Wider Issue of the Law**: Australian legislation seems to be grouped into two categories:
    a. Enforced legislation. This usually relates to small offences or obvious things like parking, speeding, theft, vandalism, assault or murder.
    b. Unenforced legislation. This relates to many white collar offences, online or credit card fraud (the latter hidden by banks and paid for with extortionate interest rates), tax evasion, royalty evasion, water theft and many financial crimes. The key features of these are that they are either committed by big people or are less visible.

    There is a growing awareness and disquiet, about these two categories of crimes and the anxiety is damaging the fabric of society as faith in both the governments and the legal system ebbs.

20. **Bank Responses**: It is unsurprising that after embarrassing hearing and before any retribution is decided the banks are contrite and apologetic. Policy changes are trumpeted. But individual restitution does not follow unless there is action from the customer and if there is no ongoing change in monitoring, identification of wrongdoing and punishment the storm is likely to blow over and behaviour to return to normal. This is especially so if there is

no significant legislative or regulatory change. Many Royal Commission reports achieve no change because of the lack of political will for change and a lack of advocacy to follow through good findings and recommendations.

21. **'Bottom-Up' in practice**: The many examples of poor practice surely demand penalties and the fact that they have continued for so long and despite the FoFA changes is clear evidence that the regulatory regime with ASIC has not worked. Only a 'bottom-up' system where those affected kick-start a retribution process that is followed through by regulators can achieve the significant culture change at the top of our financial entities, where the stratospheric salaries both indicate and reinforce the concept that what CEOs do and receive is in no way related to the average person. The information and exchange of information at the Ombudsman's office would form a filter and set an initial decision which could be pursued by the normal appeal process of law and this may or may not impinge further on the actions taken by the regulator. At the lowest level the complaint or report is a data item on a number of issues to be considered as part of that data set assessing the complainant, institution, type of product and process involved. If it is indicative of very poor behaviour or becomes significant due to legal precedent of other reason, that could be dealt with on its merits. The 'bottom up' concept involving an Ombudsman's office does not stop existing mechanisms. It rather supplements them, empowering consumers in response to the manifest failures of the existing regulatory, prosecutory and tort systems.
22. **Current Absurdities:** The absurd idea (11.3.2 page 145) that a 'Notice of Breach' is an enforcement mechanism must be challenged. What is next? Shoplifters dobbing themselves in to the nearest Police Station?

    The idea that 'giving financial advice' is not a profession (as discussed in 11.4 page 148) is similarly absurd. While it is true that many of its practitioners are less than professional in approach, it is an entire industry with structure and products.

    The idea that Industry Associations such as FPA or AFA can monitor standards is also absurd and outmoded. Who can forget the tobacco industry self-regulating its codes? As stated above the self-regulatory approach to 'expel' members as an 'extreme' approach is merely a laughable PR stunt and needs to be called out as such. Self-regulation is regulation of the self, by the self and for the self.

23. **Need for Individual Registration**: Like doctors or any other occupation that requires training and ethics, registration must be by an external body. Standards must be set by legislation and regulation and enforced by a body with expertise in the area.

    Every person seeking to give financial advice in a professional capacity must be registered and come within the ambit of a regulator such as AHPRA (Australian Health Practitioners Registration Agency). Sales agents working for a financial entity need to be registered so that they can be deregistered and banned for unacceptable conduct. The entity whose product they are selling must also bear responsibility for the appropriateness of the product for the customer.

    It would appear currently that selling financial products is like selling vacuum cleaners or real estate with success measured by sales value and the sales force interchangeable.

24. **Implementation of Regulation**: The 'bottom-up' regulatory regime that is advocated would have identified bad behaviour or further legal action. Apart for any action that a consumer may take the matter may be referred to a number of bodies in the current regulatory framework. Ideally there would be only one, but hopefully the Ombudsman's office would monitor the progress of issues raised by complaints and also the effectiveness of ASIC and/or the other regulatory bodies.

    Ethical standards (11.6 page 152) are often sources of fine rhetoric. Legal standards are more concrete and so can be enforced, and must be with realistic deterrence including gaol time. The fact that people rarely go to prison for white collar crime and that regulatory enforcement seems largely negotiated financial restitution of a relatively small percentage of monies transferred or obtained makes it more like a game, particularly when the individual rarely has to come up with any money at a personal level.

    The Issues that have emerged in (12, page 154) are complex, but simple concepts of ethics and fairness need to be enforced. This should be the key to how an Ombudsman's office would deal with a complaint and its discussion and resolution. A working knowledge of the law is likely to enable the complaint handler to classify which regulation or standard has been breached as restitution is requested. It is extraordinary that in a complex financial system the regulators who should be answering the questions on pages 155-157 are still asking them. It seems that they have lost touch with the grass roots and do not know how to do their job. No wonder that the financial entities toy with their customers.

25. **The Code of Banking**: The Code of Banking Practice is another example of self-regulation substituting for legislation and regulation. If it is to give substance to a general statement that a banker must behave with prudence and diligence and seeks to define those terms, it is clearly written by the banks and for the banks if it 'does not set out clearly what they promised'. (Page 165 reference 30). This is extremely convenient. If the Code is not binding and it is not clear what it promises it will not have clear obligations that banks can be accused of breaching. Clearly if ASIC then approves the Code as a substitute for something more substantial the ABA can guarantee that the worst that can happen is that they will be hit by a warm lettuce.

    The Code may go beyond the law, but if it is 'voluntary' and its presence encourages the law to go less far, it has achieved a corresponding reduction in the danger of prosecution. A prosecutor will have trouble proving that a banker was not 'prudent and diligent' if these terms are not defined. There will be a lot of 'wriggle room'.

    26 **Real Estate 'Securitisation**: The continual use of the family home as security for loans means that banks do not really have to consider whether a business is likely to succeed (page 169) as their loan is secured irrespective of this. The supernormal profits of real estate investment, which has become speculation on a certainty has been caused by the changes in the capital gains tax and the huge benefits of negative gearing as a tax deduction. This has made real estate investment a 'no-brainer', hugely inflated prices, raised Australia's private debt to close to the highest in the world, put us in hock to overseas banks and drained potential investment capital from other areas. But a less noticed outcome has been that it

has allowed banks to lose expertise in assessing the prospects of businesses who seek loans. This weakening of the financial assessment function for new ventures is bad in terms of prudent social policy. Banks need this expertise for their own good and for society's. Hopefully it will be remedied slowly as dependence on home mortgages is lessened, but policy consideration needs to be given both to home prices, the use of mortgagees as the major securitisation of loans and the need to rebuild bankers' expertise in business risk assessment.

27. **Bank Confessions**: The laundry list of offences acknowledged by the Banks on pages 170-171 is remarkable for the fact that this is how a Royal commission has to find what amounts to criminal acts.
28. **More General Issues**, (6 page 180) notes that banks have the power to change conditions at will. So do insurers. There needs to be some guarantee that if a contract is signed and the weaker party meets the terms, those terms cannot be changed so that the weaker party defaults in consequence of that change. An example of this might be a change in the banks category of risk such that the interest rate rises to a level that the weaker party cannot service and is forced into bankruptcy.
    IN terms of Banks' power, if a lender makes a loan that a 'prudent and diligent' banker would not have made and loses their money, there must be some statutory limit on the lengths that they can go to recover it. The ruination of lives forever or the pursuit of partners (sexually acquired debt) to recover relatively trivial amounts may amount to unreasonable harassment. When small people make a bad investment and lose money it is regarded as 'Tough luck'. Silly them. These losses are frequently due to an interest more powerful than the investor losing money, and the small person loses the money in consequence and can do nothing about it, such as a fall in a share price. There is no reason why banks, merely because they have more power should be able to squeeze a weaker party to a far greater extent than the small investor ever could.
29. **Agricultural Lending**: In section 6 Agricultural Lending (page 225) there is again a litany of bad behaviours by banks and more testimony to the ineffectiveness of the regulators in looking after the public interest. The greed and lack of care of the weaker party by receivers is the stuff of legend.
    Agricultural loans have higher risk than other loans because of the large number of uncontrollable factors in farm income. The weather is the one most frequently cited but market fluctuations related to commodity price manipulations are significant and often overlooked. The loans need to have insurance, or be seen as in essence a hybrid insurance product. How this concept can be translated into practiced laws or products is more difficult but needs to be addressed. It is not reasonable that all the risk be taken by the farmer. Banks in their 'prudent and diligent' role must take more of the risk than hitherto.
30. **Land Valuation** (4.3 Page 245) is very variable with time. New Zealand has a government department that maintains a national system of valuation, known as QV (Queen's Valuation). This maintains a database of land sales and also takes into account money spent on property development, which is received as council development applications. The database is used for rates calculations and is also a

benchmark for sales. Such an institution would give more stability and credibility to land valuations in Australia.

31. **Distressed Banks?** In dealing with distressed loan (4.4 page 249) it was interesting that the banks were unable to say what distressed loans actually cost, and one wonders if an arbitrary rise in interest was simply created as a punishment or disincentive to borrowers or if the rate selected was higher than the costs were likely to be reasonably expect that the banks should be able to justify costs and that they should be asked to do so by an effective regulator in the interest of good public policy (page 250).
32. **Dead Insurance**: It would seem obvious that selling funeral insurance (2 Page 262) to young people is good health is likely to be a 'rip-off'. Presumably a 'prudent and diligent' banker would know this, but whether he would know that a sure-fire profit was unethical is another question. Not only the banker, but the insurance sales representative needs to covered in a regulatory framework that stops this type of sale. Premiums must reflect risk and this needs to be able to be justified to an actuarial auditor. When this is drawn to the attention of the Ombudsman not only the signal case, but others like it need to be identified in a pro-active manner and the selling method of that type of product assessed. The Ombudsman should then issue a directive that if sales are unreasonably exploitative that the premiums will be refunded and the salesmen and insurer fined.

    The two ideas that a company has the right to unlimited profit and that the market will provide discipline may be beloved of some CEOs and laissez-faire capitalists but simply observing Darwinian exploitation with a cheery 'caveat emptor' is not a sound basis for public policy. This is an aspect that would be fixed by a bottom up regime of an Ombudsman and is clearly not being addressed by the current ASIC regime.

33. **Issues that have emerged** (3 page 364).

a. **Indigenous issues** are similar to those that exist for all groups disadvantaged in their ability to deal with the financial sector and a bottom-up empowerment system is the best way to identify the issues and make possible restoration and retribution for individuals who have been exploited and systemic change in the interests of all.
b. **The Regulation of the Regulators** (8 page 267) involves the identification of bank culture and its problems. The clear statement that 'Profit remained the informing value' (page 269) summed the situation up well. It might be argued that the insurance industry is actually worse than the banks as they are able to suggest that all claims are fraudulent, so that delays and harassments are a necessary part of doing business. As started in my previous submission this is the case and further investigation of insurers by the Royal Commission is needed, particularly in the area of claims management.
c. **The actions of ASIC** (2 page 270) in the (non-)enforcement of the law illustrates the appalling double standard of law enforcement in Australia. Could one imagine a situation where a kid suspected of stealing Mars bars from a 711 store would be asked to report his own crimes? Would the Mars bar thief merely have to apologise and put it

back, or have an unmonitored ban on vising convenience stores? Would a person caught speeding have no points recorded because he paid his infringement fine?

d. It is not just ASIC that does not get it. **It is the whole government attitude to power**. 'We are scared of you, so you will be above normal laws'. The people are sick of this. It is time that other such powers that be, such as this Royal Commission called out this behaviour for what it is, clarified the cause of the unease about governance and justice that is widely felt in the community, stated clearly that the law exists for all and advocated for mechanisms to enforce this. Government cowardice is no excuse. In economic terms capitalism supposedly gives advantages because competition drives down prices. However larger businesses have advantages of monopoly or oligopoly pricing which allows them to overcome their smaller competitors who are restricted to a single product in a single market. It is therefore very important that they cannot engage in unethical competition and that this is enforced by a neutral regulator. It is significant that he ANZ could issue thousands of offers of credit in breach of their prudent lending obligations, state that they were unaware of this and have no penalty. Smaller organisations would not even be able to attempt this. Size is ubiquity.
e. **The Infringement Notices** (2.3 Page 274) and the derisory amounts ($13 Million) merely shows how little the financial penalties are to banks and this is tied to the fact that there is no publicity when this occurs, so no public scrutiny of opprobrium. The financially savvy who know what is happening and also know what a tiny percentage of the benefit of the action might be consumed in a possible fine and its probability. The public have a sense of unease that something is not right, but are unsure of its nature. The lack of bans and actions against advisers who do not act in the interests of their clients is nothing short of a disgrace. It is the idea that anyone can sell anything to anyone with a caveat emptor approach. Would action be taken against doctors known to do unnecessary operations to make money? (There is no database to measure quality control, but there is at least a complaints system).
f. **The lack of publicity** for banning advisers on the grounds of 'procedural fairness' presumably allows the banned person to change careers slightly and proceed. Does a Mars bar thief have similar reputational protection and how dangerous is he/she to the general public? How can ASIC complain about the quality of advisers when it is the enforcer of standards? Is it begging for the power to do something? Eliminating known problems is a good start, and it should have a plan or at least a statement of needs. The report states the problems in Responding to Misconduct (2.5 Page 277), but needs to demand that ASIC is more active in prosecuting known misdeeds. The timid approach of ASIC in Implementing New Provision (2.6 page 281) such as the unfair contract terms (UCT) further illustrates its weakness and would reinforce the powerful corporations' feeling that they could do what they liked with the smaller people. The government's fundamental duty to act in the interest of the people is tacitly ignored as usual. When ASIC claims it has limited powers (2.7 Page 285), this is somewhat lame if they are not using the powers that they have. The most charitable explanation that can be found is that it has a non-activist leader who wants to feel that there is demonstrated government support for stronger action.

g. **Effete Advice:** The comment of Neil Gunningham (footnote page 287) can only be amplified:

'[The] dangers in adopting a pure 'advise and persuade' or compliance oriented strategy of enforcement, which can easily degenerate into intolerable laxity and fail to deter those who have no interest in complying voluntarily. More broadly, there is considerable evidence that cooperative approaches may actually discourage improved regulatory performance amongst better actors if agencies permit lawbreakers to go unpunished'. The advantages of having a conviction over some 'policy advice' in terms of behaviour change is huge but the public shaming of powerful people is important, particularly for those who consider themselves so far above others that they do not even consider how many multiples of normal salaries that they have. The use of stocks was somewhat misused in olden times, but to be photographed in handcuffs or prison greens might add a considerable deterrent to white collar crime. The contrast to this was Alan Bond's short stretch in prison after terrible but seemingly short-lived memory problems in the Court. After his bankruptcy decision where his creditors got less than one cent in the dollar he emerged from the Court cheerily in a suit and said, 'It was a very fair settlement'. The problem of fines is that they are paid by the corporation as a cost, which is effectively from the shareholders and may not affect the CEO personally at all. Physical goods stolen have heavy penalties, yet white collar crime of the same magnitude has far lesser penalties despite the fact that those affected are often more vulnerable and have little chance of redress through insurance. Penalties must be increased to change this, and more importantly they must actually be applied.

h. **Dysfunction of the existing Legal System**: In terms of dealing with the financial and opportunity costs of litigation, one can only comment that the cost and cumbersomeness of the legal system is probably the main cause of injustice in Australia today. The public seems far more aware of this than either the legal profession or the politicians who pass the laws.

i. **Future Hopes**: One can only hope that an Ombudsman's office dealing with clear complaints of unsatisfactory dealings will take these forward and that they, ASCI or other enforcing body will pursue cases, achieve results and use these to continue to change the culture and lessen the number of crimes and misdemeanours committed.

The point is well made, (in 3 Future Regulation page 289) that increasing the complexity of laws and regulations make both compliance and enforcement more difficult and leads to semantic battles and a 'tick box' approach or black letter law. Normal people are depowered and specialist lawyers rendered an expensive necessity.

Laws should be simple and contrived schemes to evade them should be judged by their practical consequences with the moral force of the law rather than the compliance or not of a cascade of regulatory subclauses.

34. **The Place of the Banking Code of Practice** (3.2 page 291).

The fact that there is some non-banking input to a regulatory code is welcome. The idea that industries can set their own rules needs to be challenged. All jobs and professions must fit into a social framework of tasks, and responsibilities as well as privileges. It is worrying that laws which effectively give codes enforceability in law under the Competition and Consumer Act 2010 do not apply to the banking code. How much non-regulation do they need?

It is true that 'the enforcement of these norms [the Banking Code of Practice] should not be left to borrowers' (page 292). However borrowers should be empowered to trigger a process that leads to enforcement of laws, regulations and codes and they need to be able to do this at relatively low cost. If an Ombudsman's office gets many complaints and little enforcement the nature of extent of this disparity will be readily evident, provided that the Ombudsman's office is obliged to produce full reports of their activities and data. The office would provide a filter, but this filter must not be a block to reasonable action and redress.

35. **Funding and Governance of the Ombudsman**: It is important that the Ombudsman be funded from general revenue so that it is not a captive of the industry it is supposedly regulating, and that its office should be under a different Minister from the one who supervises the regulated industries. A common sequence of events is that a Minister relies on an industry for his/her success and advancement, tends to see their interest as his/her own and cuts the budget of the regulator to lessen their costs and any possible mutual embarrassment that the regulator may cause. The regulator, sensing the political climate, becomes a process-driven lapdog. This would seem to be what has happened to SIRA (State Insurance Regulatory Agency) and Safework (formerly Worksafe the Occupational Health and Safety inspectorate) in NSW.

As far as the Future Regulators are concerned (4 page 293) it is stated above that an Ombudsman's office driven from the bottom up and empowering small people affected by big institutions behaviour need to be empowered to initiate action and that this 'people's regulator' should be a spur both for individual litigation and for more informed regulation.

36 **Entities: Causes of misconduct** (9 Page 301).

The preeminent drivers of bank behaviour was profit and the remuneration packages reflect the desire to encourage behaviours that contribute to sales and profits, and undermined ethical and public service obligations.

The situation is exactly the same with insurance, but in insurance there is greater ability to stigmatise the injured clients and the ability to withhold benefits, which is considerably easier than achieving sales. The moral hazard is far greater in insurance than in banking. For these reasons the behaviour of the insurance industry is worse than the banks and they need further investigation by the Royal Commission, particularly with regards to claims management. I would urge that he Royal Commissioner seek an extension of its term to address this matter.

37. Response; Changing the Remuneration and changing culture

While there is payments by profits, culture will be difficult to change. This obsession with a market model in every aspect of life is extant in society, even in many areas such as welfare and health where a market model is not really appropriate due to lack of information for buyers. In areas where there is a market and the entity is dependent on a profit for survival and in continual competition in the same field, it will be difficult to change the ethos.

38. **Government-owned Banks and Insurers; The NZ Model**: From a public perspective banking, insurance and financial advice are merely necessary evils. They do not by definition have to be profitable from a consumer's point of view; they merely have to be competently executed. Those who would have you believe that these services could not exist without profit are not correct. As far as banking is concerned the NZ government created Kiwibank to deliver basic services. Kiwibank does this very well and must surely have a regulatory effect by being a competitor in the market. After the war NZ also established the Earthquake and War Damage Commission, now known as the EQC or Natural Disaster Fund. This is funded by a levy on all home insurance and built up a large reserve, which was far more useful than private insurers after the Christchurch earthquakes of 2010 and the more damaging one in 2011. Private insurers caviled over details and definitions, whereas the EQC did its best to balance competing claims and spend its money wisely, which was obviously difficult in a political context. Australia should emulate both of these institutions and the Royal Commission should recommend this.
39. **Insurance should be a public good** and its massive reserves should be used as such, but it has become a massively profitable scam. There needs to be both a significant government presence of insurers in each category of insurance. There also needs to be a regulatory regime with an Ombudsman connected to an informed by consumer complaints.
40. **Financial Services for Distressed Consumers:** Financial services may be more difficult to regulate as they are more diffuse, though on the other hand they may be less politically powerful. Certainly strengthening advice services for those in financial distress of at risk would help. They also need to have a publicity drive and an improvement in their referral pathways from other help agencies would also be good. It might be a good regulation to have them advertised compulsorily in gambling venues for example.
41. **Pay Salaries, Not Bonuses:** The use of salaries to pay people to execute their normal duties competently has been pushed aside for bonus schemes in the race for incentives for profits. Inherent in this is the assumption that people will not work as hard for salaries as they will for commissions or bonuses. At times the wages have been lowered to make the bonus schemes a necessary part of their income, which surely forces employees to follow the priorities of the organisation rather than be swayed by any personal moral values or sense of duty to their customers. From a customer/consumer point of view it would be better if all

providers of financial services were salaried and cost-neutral in the advice that they were giving. Whether this can be legislated or enforced is a difficult question, but a statement that sales incentives are likely to distort behaviours should be a basic starting point. The assumption should be that any incentive that distorts advice is against the consumer's interest and such distortion should have to be justified. Incentives should not be the norm or the default. In essence they exist for increasing sales, not giving neutral advice. A salaried service in banking, insurance and financial counselling shroud be provided by the government.

42. **A Market Model leads to Regulatory Capture**: There is a real danger that the public sector itself is becoming infected with the idea that saving or making money is an end in itself. In NSW the government boasted that it had saved money on CTP and handed premium money back to motorists as an eligibility related to their previous year's premium[1], and gained praise for doing so[2]. This was despite the fact that many patients remain untreated due to the ruthless and callous behaviour of Insurers[3] and the poor regulator control who make no effort to collect statistics on inadequate treatment and who conveniently refuse to consider 'medical questi0ons' and refer patients refused by insurers to panels of doctors whose appointment selection criteria may be influenced by insurers[4] in what appears to be regulatory capture secondary to government captures by the insurance lobby.

This has gone a step further with NSW motorists only covered for 6 months after an accident before they are on the Medicare system or their own private funds, unless they have an injury that is over 10% in the AMA tables[5]. Very few patients make this threshold and there are many patients below the 10% threshold who are still in a lot of pain and/or are unable to work. The government sold this as a huge win for the public[6], which it may be for those who do not have an accident. So the ideology of the market has large implications for the collective sharing of risk that is the essence of insurance. The system was implemented on 1 December 2017, so there is now a growing cohort of patients who still have problems but have been ejected from the scheme. It also appears that insurers are delaying treatments so that the 6 months

[1] www.service.nsw.gov.au/transaction/claim-ctp-green-slip-refund

[2] www.dailytelegraph.com.au/news/nsw/ctp-reforms-how-to-claim-your-green-slip-refund/news-story/637e792b9a92f6fe77695e39d55f0519

[3] See Chesterfield-Evans previous submission to Royal Commission 'Systemic Problems in the Insurance Industry with special reference to NSW CTP and Workers Compensation'

[4] See Chesterfield-Evans 'Submission re Actions to be taken in response to the Insurance Findings of the Royal Commission' submitted 26/10/18

[5] The American Medical Association Guides for the Evaluation of Permanent Impairment, usually referred to as the AMA Guides attempt to give a standard result for any trained physician to a given patient's impairment, which is then expressed as a percentage of 'Whole Person Impairment' (WPI). It does not consider things that cannot be measured such as pain, so it is beloved of insurers for its consistency and its low values whereas patients, who have a good range of movement but a lot of pain score low, cannot work and get little compensation.

[6] www.smh.com.au/national/nsw/ctp-greenslip-changes-a-big-win-for-motorists-says-government-20170307-guskzv.html

will expire and they can transfer costs[7]. This is exactly what could have been expected from such a scheme.

43. **Performance Indicators as Distorters of Performance**: The frequently farcical 'Key Performance Indicators' KPIs formerly so beloved of manager have now been replaced in the ANZ (4.1 ANZ page 309) by quantitative financial indices and it is unsurprising that the efforts to turn back the clock to pre-financial KPIs have been unsuccessful.

The key point is that 'performance indicators' generally improve because they are focused on and other aspects of the task suffer corresponding neglect. Managers are empowered and employees correspondingly depowered. Yet management theory says that the best way to optimise performance is opt have the best decisions made at the lowest level in the organisation. My own research the fact that workplace absence is minimised and job satisfaction maximised if workers can do their jobs using their own judgement with as much autonomy as possible. Assuming that they like their jobs and that they are in a service role they could do this on a salary and wood balance the interests of their clients and their employer adequately if allowed to do so. The use of incentives and rigid protocols are unlikely to be in the public interest (except insofar as protocols have an educative function and may add consistency to an institutional response.

The twisting of a 'needs based conversation' into a 'sales opportunity' (Page 312) is the kind of management doublespeak that is at the heart of the problem.

44. **Empowerment of Consumers**: In answer to the questions in 5. Changed remuneration (Page 316) and changed culture and 6 What can.. be done…? (page 317) it can be stated that incentive remuneration is not necessary for bank staff. What has been forgotten is that Banks are there primarily to provide a service to customers and society in general. If you want to know what is wrong with them or how to improve them, ask the customers for whom they actually exist and who sustain them.

Surveys may be able to do this but if the application o of the result does not increase bank profits there is little likelihood of their implementation. Another way of improving services is to remove problems systematically starting with the most frequent or serious ones. An Ombudsman-type complaints collection system would do this and would remain timely. The creation of this resource is likely to do more for an improvement of the system than tinkering with regulations as it will be based on recognised needs.

45. **Failure of APRA and Top-Down Regulation**: With regard to 6.6 Regulatory Intervention (Page 318) all that can be said is that APRA appears not to understand the problem. Either they are too focused on the stability of the

[7] Personal experience. Data being collected.

system to see its exploitative nature or they regard this as normal, or they think the regulation behaviour within the system is someone else's job. The fact that the best that they can come up with is a pious press statement on the need for better self-regulation[8] is a message that they will need at least an Ombudsman with an outrageous case or statistics on much unsatisfactory behaviour and a considerable amount of political pressure for them to be of any use as a regulator.

46. **Intermediaries should be tolerated if they are behaving**: Intermediaries should have the clients' interest first, but how they can do this if they are paid on commission is hard to determine. Ideally they would have a fixed and fee paid by the customer to get an ideal loan. But if information were available as it should be their role would not be necessary, assuming that people actually go and get what they want and salespersons and commission agents who sell loans are actually not necessary.

If the intermediary role is retained, the intermediary should have the client's interest stated as their primary role and the complaints system should allow consumer redress if they do not do so.

The old-fashioned view that advertising for basic products is not necessary because people know when they need things like loans, financial advice or insurance. By this logic, much of marketing with agents is unnecessary. Traditional economic theory was based on making decisions about a shortage of goods, but in practice now the product exists first and the demand is created later. Whether this is the consumers' interest in banking or insurance is more doubtful, but it would be wise public policy to let them act as long as they are in the client's interest, but curtail that which is not.

[8] APRA Media Release 1/5/18 as quoted on page 320 of interim Report of Royal Commission on Banking etc.