

**ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND
FINANCIAL SERVICES INDUSTRY**

SECOND ROUND OF PUBLIC HEARINGS: FINANCIAL ADVICE

**SUBMISSION OF NATIONAL AUSTRALIA BANK – SUBMISSION IN RESPONSE TO QUESTIONS
ARISING FROM THE SECOND ROUND OF PUBLIC HEARINGS**

A. INTRODUCTION

1 National Australia Bank Limited (**NAB**) provides the following submission in response to Counsel Assisting's invitation to respond to the general questions arising from the case studies considered in the second round of public hearings concerning financial advice.

2 While each of the questions posed by Counsel Assisting raise important matters for consideration, a number of the questions are not capable of a comprehensive or meaningful response at this point, having regard amongst other things to the evidence presently before the Commission.¹

3 In the circumstances, NAB's approach in responding to the questions is as follows:

a. where a particular question can be addressed by reference to evidence presently before the Commission, that has been answered by reference to NAB's view on the issue raised by the question;

b. Certain of the questions require more comprehensive investigation and review before a meaningful answer can be proffered. Although NAB is not at this stage in a position to provide a substantive response to these questions, it has, where appropriate, sought to assist the Commission by identifying key matters which would need to be further considered and explored to enable meaningful answers to be given.

B. CASE STUDY 1 - FEES FOR NO SERVICE

4 **Question 1:** *Do clients receive any meaningful benefit from ongoing service arrangements?*

5 **NAB's response:** NAB considers that clients do receive a meaningful benefit from ongoing service arrangements.

¹ By the phrase "evidence presently before this Commission", NAB is referring to documentary evidence, including witness statements and exhibits tendered before the Commission, and oral testimony of witnesses before the Commission as at the conclusion of the second round of public hearings on 27 April 2018.

6 NAB's ongoing service arrangements provide clients with: (a) an opportunity to have a regular review of their financial plan; (b) regular access to newsletters, articles and seminars which keep clients informed of the changing regulatory landscape which can have a significant impact on their investments; and (c) immediate access to financial advice should the client need it at any time throughout the course of the ongoing relationship.

7 The benefits that clients receive from ongoing service arrangements must be assessed on an individual basis. However, at a general level, all clients who engage a financial adviser for the provision of personal financial advice have short-term, medium term and long-term objectives and their circumstances typically change over time. Further, their investments are not static. In that context, the provision of personal financial advice through an ongoing service arrangement for those clients who opt to receive ongoing service – in particular a regular review of the clients' financial position referred to in paragraph 6 above – is of benefit to those clients. Regular reviews:

- a. prompt clients to plan actively to achieve their long-term objectives. It is NAB's experience that it is not uncommon for clients to be passive in respect of reviewing their financial objectives. Regular reviews prompt direct engagement with those strategies; and
- b. allow the financial adviser and the client to ensure that those strategies match the clients' changed circumstances and goals, movements in markets, and changes in regulations, and to adjust their strategies appropriately if necessary. The regular review also gives clients peace of mind in respect of these changes.²

8 **Question 2:** *To what extent does the continued legislative condoning of grandfathered commissions shape and influence the culture and attitudes of financial advice licensees so as to create a disconnect between community expectations as to the charging of fees, and the tolerance of licensees for the charging of fees for no or little service?*

9 **NAB's response:** NAB's experience is that the community expects that financial advice clients only be charged for services which are in fact provided consistently with agreed ongoing service arrangements. NAB also understands that the community expects that financial advisers will only recommend that a client invest in a financial product if that investment is in the client's best interests, and that what the financial adviser may gain from that recommendation (by way of grandfathered commission for example) should not play into the recommendation.

² NAB respectfully adopts the evidence of Mr Michael Wright (Westpac) on this issue. He gave evidence at T1450.15-1451.5 as to the nature of what is provided pursuant to ongoing service arrangements and the benefits to clients arising from those arrangements. Those benefits are aligned to what NAB considers to be key meaningful benefits from ongoing service arrangements.

- 10 While NAB considers there are benefits to clients in the provision of ongoing service arrangements (in particular those set out in answer to Question 1 above), NAB accepts that there is a need within the industry to better educate clients about these benefits. Further, there is a need to improve the controls around identifying and preventing situations where fees are charged for no services or poor services, inconsistently with community and NAB licensee expectations.
- 11 NAB also accepts that given the legislative provisions that permit grandfathered commissions, licensees have continued to rely on commission arrangements and intend to do so until the long tail of the Future of Financial Advice (**FoFA**) grandfathering regime ceases, or grandfathered commissions are otherwise terminated. NAB agrees this gives rise to a tension, and may in some circumstances create a “disconnect”, between the duty of financial advisers to act in their clients’ best interests and the ongoing receipt by those financial advisers of grandfathered commissions. NAB has taken steps to address that tension as described in paragraphs 12 and 13 below.
- 12 *First*, the NAB Group has led the industry *away* from commission based financial adviser remuneration structures, including by transitioning its employed financial advisers at NAB Financial Planning (**NAB FP**) to a fee for service arrangement. NAB FP’s move to fee for service was actively encouraged in the lead up to FoFA reforms during engagements with the Government and with senior ASIC executives. During the course of these engagements, it became apparent that commission based remuneration structures were opaque and client understanding of them was low. The move to a fee for service model by NAB FP has therefore sought to address any disconnect with community expectations as to the charging of ongoing service fees. It was an important change for the better of clients of NAB FP as those clients are now able to agree, see and stop fees that relate to their service, should they so wish.
- 13 *Second*, to the extent that grandfathered commissions continue to be provided to NAB’s authorised representatives, NAB has engaged in substantial work since the enactment of the FoFA reforms to address the tension referred to at paragraph 11 above in order to ensure that the existing legislative regime for grandfathered commissions does not affect the advice given by its employed financial advisers. By way of example only, since 2013, NAB has:
- a. adopted key policies including the Advice, Compliance and Policy Guide³, the Group Whistleblower Policy⁴, the Guide to Adviser Profiling⁵ and the Licensee Standards⁶,

³ WIT.0001.0026.0001, Statement of Andrew Paul Hagger dated 13 April 2018 with Exhibit AH-2 tendered as Exhibit 2.179 (**Hagger Statement 2**), in response to Rubric 2-21, tab 24, NAB.061.003.6897.

⁴ Hagger Statement 2, tab 25, NAB.001.001.0049.

⁵ Hagger Statement 2, tab 27, NAB.061.003.4956.

⁶ The Licensee Standards are set out in Hagger Statement 2 at [43(d)].

which, *inter alia*, impose obligations on financial advisers and are all designed to ensure that financial advisers act in their clients' best interests and conduct all dealings with clients in an honest, efficient, and fair manner;⁷

- b. implemented a range of financial adviser training modules on conflicted remuneration, the best interests duty, fee disclosure statements and opt-in measures with respect to ongoing service fees;⁸
- c. maintained and implemented detailed audit and compliance policies which include not only annual audits but the introduction of regular themed reviews of financial advisers based on high-risk areas or topics of concern;⁹
- d. appointed an Independent Customer Advocate who has been engaged across the advice business, providing critical client insights and perspectives across many aspects of the business¹⁰; and
- e. adopted processes and procedures to manage potential conflicts of interest, (including those conflicts associated with recommending clients maintain their investment in a product which would result in the ongoing payment of a grandfathered commission), including the Licensee Conflict of Interest Standard, the Conflicts of Interest Policy and the Licensee Standard – Best Interests Obligations (the **Best Interests Standard**) (which sets out the “Conflicts Priority Rule”).¹¹

14 **Question 3: Should grandfathered commissions cease?**

15 **NAB's response:** NAB does not oppose in principle the cessation of grandfathered commissions¹², but it considers that any such cessation should be subject to a reasonable further sunset period. It is acknowledged that the FoFA grandfathering regime has a long tail itself and NAB is not suggesting such a lengthy sunset period. However, a reasonable sunset period is practically necessary in circumstances where certain grandfathered commissions (including those given to NAB financial advisers under existing contracts) continue to be provided.

16 In that regard, NAB notes the following evidence of Mr Michael Wright (Westpac):

⁷ Hagger Statement 2 at [43]ff.

⁸ Hagger Statement 2 at [49].

⁹ WIT.0001.0022.0001, Statement of Andrew Paul Hagger dated 5 April 2018 with Exhibit AH-1 tendered as Exhibit 2.178 (**Hagger Statement 1**), in response to Rubric 2-9, at [46]-[66]; Hagger Statement 2 at [62]-[80].

¹⁰ Hagger Statement 2 at [101].

¹¹ See WIT.0001.0023.0001, Statement of Ross Andrew Barnwell dated 13 April 2018 with Exhibit RAB-1 tendered as Exhibit 2.8 (**Barnwell Statement**), in response to Rubric 2-34 parts A and B, at [71]-[74].

¹² The reference to “grandfathered commissions” in answer to this Question 3 is a reference to those commissions that are covered by grandfathering regulations or exemptions contained in Part 7.7A, Division 4, Subdivision 5 of the *Corporations Regulations 2001* (Cth) and does not include the commissions referred to in Section F below.

- a. the legislative provisions which continue to allow grandfathered commissions were arrived at following consideration by the Government of the potential legal and constitutional consequences of overriding existing and accrued contractual rights and having regard to the likely adverse impact on financial advisers and advice business, including in particular small to medium sized advice business.¹³ The cessation of grandfathered commissions likely would have a substantial impact on authorised representatives, many of whom comprise small businesses whose revenue is significantly reliant on grandfathered commissions;
- b. if an organisation (e.g. a product issuer or a licensee) decided unilaterally to cease paying grandfathered commissions, the reality is it would place that organisation in a position of “a very significant competitive disadvantage”.¹⁴ (Indeed, NAB FP has suffered not insignificant commercial loss in its move to a fee for service model as is explained at paragraph 12 above.)

C. CASE STUDY 2 – INVESTMENT PLATFORM FEES

17 **Question 1:** *Does vertical integration of platform operators with advice licensees serve the interests of clients? If so, how?*

18 **NAB’s response:** NAB considers that vertical integration of platform operators with advice licensees can operate to serve the interests of clients, so long as conflicts of interests are appropriately managed.

19 In his oral evidence Mr Andrew Hagger (Chief Customer Officer in the Consumer Banking and Wealth Management Division at NAB) was asked by Counsel Assisting whether he thought it desirable that the provision of financial advice be separated from those entities which also issue financial products.¹⁵ Mr Hagger’s response was, inter alia, that vertical integration of platform operators with advice licensees can serve the interests of clients particularly given that “clients – and we have many - appreciate the fact that a big institution is standing behind the advice, that there are quality standards” and that in the event clients’ interests are not served, NAB will compensate those clients.¹⁶

20 ASIC has also acknowledged that vertical integration has potential benefits for clients¹⁷:

Vertical integration can provide economies of scale and other benefits for both the financial institution and its customers. The economies of scale may allow customers

¹³ See WBC.900.001.0326, Statement of Michael Wright dated 16 April 2018 tendered as Exhibit 2.10, at [14].

¹⁴ Wright XXN at T1446.12-16.

¹⁵ Hagger XXN at T1703.25-27.

¹⁶ Hagger XXN at T1703.27-41.

¹⁷ See [51(a)] and [218] of ASIC.0902.0001.3284, Statement of Peter Kell dated 12 April 2018 with Exhibit PK-1 to PK-45 tendered as Exhibit 2.1 (**Kell Statement**) and ASIC Report 562 at [8], exhibited to Kell Statement, PK-7, ASIC.0015.0001.5455.

to access advice at lower cost. Customers may choose to obtain both advice and financial products from a vertically integrated institution because of the convenience of a relationship with a single financial institution. They may also value the perceived safety of dealing with a large institution, and have trust and confidence in the ability of the institution to both deliver the services and compensate them appropriately if required.

- 21 NAB accepts, however, that conflicts of interest need to be managed. In his oral evidence, Mr Hagger acknowledged that advice and product are two separate things.¹⁸ He noted that NAB has in place certain mechanisms and controls that allow it to manage conflicts of interest associated with the vertical integration of platform operators with advice licensees so the interests of clients are served. Mr Hagger noted that he oversees NAB's advice business (operated through licensees) whereas Matthew Lawrance (Executive General Manager, Wealth and CEO MLC Super) oversees "product".¹⁹ Further details of the processes that NAB has in place for managing conflicts of interest are described in Section F below.
- 22 **Question 2:** *Why should a platform operator continue to receive a fee or rebate from a fund manager calculated by reference to the value of client funds invested in the fund if that fee or rebate is not wholly passed on to the clients whose funds are the basis for the fee or rebate?*
- 23 **Question 3:** *If platform operators continue to automatically deduct advice fees from clients' investments, why should the platform operator not be required to have controls in place to ensure that Subdivision B of Division 3 of Part 7.7A of the Corporations Act 2001 (Cth) has been complied with? Put another way, why should platform operators not be expected to ascertain that there is a lawful entitlement on the part of fee recipients to the moneys that the operators automatically pay to the fee recipients at the expense of clients?*
- 24 **NAB's response:** NAB makes the following response to questions 2 and 3 above.
- 25 NAB submits that there is insufficient evidence presently before the Commission to enable an answer to be given to the questions posed, at least insofar as they relate to NAB's platforms. Before these questions can be answered meaningfully, matters including the following would need to be considered and evaluated:
- a. what (if any) fees or rebates are received by NAB platform operators from fund managers, and the basis on which those fees or rebates are received;
 - b. how those fees or rebates are calculated;

¹⁸ Hagger XXN at T1703.28.

¹⁹ Hagger XXN at T1703.25-42.

- c. what amount, if any, is passed onto the clients who invest in those funds;
- d. how (if at all) advice fees are deducted in respect of NAB platforms and the legal basis on which those fees are deducted pursuant to arrangements between financial advisers and clients (for example, whether the deduction of administration fees are subject to customer consent); and
- e. what controls NAB has in place in relation to those arrangements, in particular how it ensures that any platform arrangements operate in accordance with relevant laws, including Subdivision B of Division 3 of Part 7.7A of the *Corporations Act 2001* (Cth).

It would be a lengthy and detailed undertaking to consider and evaluate these matters.

26 NAB is not in a position to comment on the position of other platform operators.

D. CASE STUDIES 3 AND 4 – INAPPROPRIATE FINANCIAL ADVICE AND IMPROPER CONDUCT BY FINANCIAL ADVISERS

Questions arising from the Westpac case study

27 **Question 1:** *Do remuneration and incentive policies that reward financial advisers for revenue generated for a licensee or employer create an unacceptable risk that financial advisers will prioritise the generation of revenue over the licensee's obligation to provide financial services in a manner that is efficient, fair and honest, over their own obligation to act in the best interests of the customer, and over their own obligation to prioritise the interests of the customer above their own interests and the interests of the licensee?*

28 **Question 2:** *How can financial services licensees best incentivise the provision of good quality financial advice, including in situations where the best advice for a customer is not to change anything at all?*

29 **NAB's response:** NAB makes the following response to Questions 1 and 2 above.

30 NAB does not consider that its remuneration and incentive policies that reward financial advisers for revenue generated for a licensee create an unacceptable risk that financial advisers will prioritise the generation of revenue over the other matters referred to in Question 1.²⁰

²⁰ In relation to conflicted remuneration, on 16 April 2018 Counsel Assisting referred to three instances of non-exempt benefits referred to in the Barnwell Statement, and stated that NAB did not disclose any of these events to the Commission in the two submissions it provided earlier this year (Counsel Assisting at T1050.32-1051.6). NAB notes that each of the instances identified by Counsel Assisting was in fact disclosed in the materials provided to the Commission on 21 and 22 February 2018.

- 31 That is because NAB has in place a variety of mechanisms and controls which work to ensure that its financial advisers act in the best interests of the client and counter any risk posed by its remuneration policies to the extent they reward financial advisers for revenue generated.²¹ Four of those mechanisms are described immediately below.
- 32 *First*, payment of any incentive that in some way rewards employed financial advisers for revenue generated for a licensee is subject to a conduct gate²². As explained by Mr Waldron in the first round of hearings before the Commission, if an employee receives a red conduct gate, they do not get a bonus and if an employee receives an amber conduct gate, the amount of any bonus is reduced by 25%.²³ The conduct gates are referable to breaches of NAB's code of conduct²⁴ and are focussed on the employee's alignment with NAB's core values and behaviours.
- 33 *Second*, individual performance plans for employed financial advisers are assessed across a range of measures, including customer-centric behaviours and proactive risk management and compliance. Consideration of performance outcomes also includes whether financial adviser behaviour aligns with NAB's values (including "passion for people" and "do the right thing"). One way in which good quality advice is rewarded through this approach is that individual performance plans for employed financial advisers are strongly linked to the management of risk (which would include, from a financial adviser's perspective, advice to a client recommending that they not change anything at all).
- 34 *Third*, one of the principal means employed by NAB to ensure that its financial advisers act in their clients' best interests is its suite of Licensee Standards, in particular the Best Interests Standard.²⁵ Paragraph 33 of the Best Interests Standard states that where there is a benefit to the financial adviser related to that financial adviser recommending a particular financial product, the financial adviser must give priority to the interests of the client.²⁶ This and the other provisions of the Best Interests Standard (and the other Licensee Standards) prioritise clients' best interests.
- 35 *Fourth*, NAB's leadership "sets the tone"²⁷ in respect of the incentivisation of the provision of good advice. This was highlighted during Mr Hagger's oral evidence where it was noted that he and members of the NAB FP leadership team received a reduction in their bonus as a

²¹ Those mechanisms and controls are outlined in detail in Hagger Statement 1 at [31]–[81]; Hagger Statement 2 at [42]–[107] as well as Barnwell Statement at [93]–[119] (in the context of the mechanisms that NAB has in place to prevent and detect conflicted remuneration).

²² For example, see Barnwell Statement, Annexure A at Item 9.

²³ Waldron XXN at T170.9–15.

²⁴ Waldron XXN at T170.35–39.

²⁵ Hagger Statement 2, tab 28, NAB.056.001.1411.

²⁶ Hagger Statement 2, tab 28, NAB.056.001.1411.

²⁷ Hagger XXN at T1697.47–1698.1.

result of the beneficiary nominations issue that was exposed through the conduct of Mr Meyn.²⁸

36 While it is acknowledged that the desire of a financial adviser to be remunerated may be a contributing factor towards the provision of inappropriate advice or dishonest conduct,²⁹ NAB considers that these are rare occurrences in respect of its financial advisers and there is no evidence to suggest that inappropriate advice or dishonest conduct is systemically tied to NAB's remuneration and incentive policies to the extent they reward financial advisers for revenue generated.

37 Nevertheless, NAB accepts that those remuneration and incentive policies that reward financial advisers for revenue generated need to be complemented with rewards that are not tied to revenue. In that regard, NAB rewards good quality advice, including through the mechanisms and incentives explained in answer to Question 2 arising from the NAB case study: see paragraphs 69 to 73 below.

38 **Question 3:** *How can financial services licensees best ensure that the results of routine compliance measures, such as compliance audits, are appropriately escalated so that potential risks to customers are identified and managed in a timely manner?*

39 **NAB's response:** NAB is not in a position to respond in respect of other licensees, but considers that its licensees can best ensure that the results of routine compliance measures are appropriately escalated so that potential risks to clients are identified and managed in a timely manner through:

- a. the introduction and implementation of measures to ensure adequate resourcing and processes associated with those compliance measures, such as reporting compliance data to regular risk forums to accelerate remediation action and ensure proper investigation and management of the impacts of non-compliance;
- b. the use of focused investigation and remediation teams to ensure a consistent approach in the escalation of routine compliance measures as well as ensuring investigations are customer focussed;
- c. the use of a centralised record-keeping system so that the licensees have continuous and immediate access to clients files;
- d. encouraging a "culture of speaking up"; and
- e. the application of appropriate accountability measures.

²⁸ Hagger XXN at T1690.22-1702.22.

²⁹ see e.g. Hagger Statement 1 at [29(a)]; Hagger Statement 2 at [39(d)] and [41(a)].

40 The following routine compliance measures are worth mentioning in the context of this question.

41 *First*, one of the key compliance mechanisms that NAB has in place to ensure that potential risks to clients are identified, escalated and managed in a timely manner is the centralised events management and breach reporting framework. That system is centred around the Event Management Policy.³⁰ Clause 4.3 of that policy deals with “Event Escalation” and provides that all employees are responsible for escalating identified events (including potential events) and that escalation must be timely and within regulatory disclosure and breach reporting timeframes.³¹ An event panel is convened after an event has been identified to determine whether the event requires escalation to the NAB Wealth Breach Review Committee (**Wealth BRC**). The Wealth BRC acts as a central body for NAB Wealth entities to assess regulatory events escalated to it. It determines whether those events should be reported to key regulators³² and it ensures appropriate decision-making as to those matters has been applied in accordance with proper processes.

42 *Second*, NAB has recently introduced changes to its financial adviser audits to provide further assurance that those audits are appropriately escalated so that potential risks to clients are identified and managed in a timely manner. In November 2017, the method of managing financial adviser audits moved from a state-based system with five different panels managed separately to a national system with one national panel.³³ This enables greater oversight of financial advisers, thereby reducing the risk of a financial adviser audit being missed or delayed, with a consequential benefit of reducing potential risks to clients.³⁴ A control has also been established to deliver a monthly reconciliation report which identifies any financial advisers whose audit has gone beyond the required time, and the reasons for this.³⁵

43 *Third*, since January 2018, NAB has introduced a “check the checker” system whereby 10% of routine financial adviser audits are escalated to a dedicated team of senior auditors.³⁶ In addition, since April 2018, the audit questions have been revised to align with ASIC’s “Report 515 Financial Advice: Review of how large institutions oversee advisers” (**ASIC Report 515**).³⁷

³⁰ Hagger Statement 1, tab 13, NAB.072.001.2957.

³¹ Hagger Statement 1, tab 13, NAB.072.001.2957 at .2963.

³² Hagger Statement 1, tab 13, NAB.072.001.2957 at .2964.

³³ Hagger Statement 2 at [79].

³⁴ Hagger Statement 2 at [79].

³⁵ Hagger Statement 2 at [79].

³⁶ Hagger Statement 2 at [80(c)].

³⁷ Hagger Statement 2 at [80(f)].

Questions arising from the ANZ (and related entities) case study

44 **Question 1:** *Is it possible for financial services licensees to adequately monitor the quality of advice provided by employees and authorised representatives where that advice is provided in a manual environment?*

45 **Question 2:** *Are improvements in technology the only way to ensure that financial advisers provide quality advice?*

46 **NAB's response:** NAB makes the following response to Questions 1 and 2 above.

47 NAB considers that, with appropriate preventative and detective controls in place, it is possible for financial services licensees to adequately monitor the quality of advice provided by employees and authorised representatives, despite that advice being provided in a manual environment. While improvements in technology are an important mechanism to monitor the quality of advice, NAB considers that improvements in technology are not the only way to ensure that financial advisers provide quality advice.

48 The following measures (technological *and* non-technological) have been introduced at NAB with a view to ensuring that employed financial advisers and authorised representatives provide quality advice³⁸:

- a. continuous improvement of Licensee Standards and related training and education, including an annual Licensee Standards exam;
- b. enhanced monitoring, supervision and training of financial advisers, including:
 - i. regular compliance audits;³⁹
 - ii. a program of regular themed reviews of financial advisers;⁴⁰
 - iii. the use of the system known as XPLAN;⁴¹
 - iv. the streamlining of systems including the Statement of Advice construction process;⁴²

³⁸ See the "Quality Advice Framework Report" dated November 2017 (**Quality Advice Report**), prepared by NAB (with input from Deloitte Touche Tohmatsu (**Deloitte**)) and summarised in Hagger Statement 2 at [44], [94]–[96], [110] and Annexure B to that statement; Hagger Statement 2, tab 32, NAB.088.001.0215.

³⁹ Hagger Statement 1 at [47]; Hagger Statement 2 at [63].

⁴⁰ Hagger Statement 2 at [64].

⁴¹ Hagger Statement 2 at [65].

⁴² Hagger Statement 2 at [66].

- v. “New Advice” training which focuses on best practice advice process, use of the enhanced template coverage of best interests, better position statement and like-for-like product comparisons;⁴³
- vi. continuing professional development training and roadshows for financial advisers;⁴⁴
- vii. the introduction of a dedicated Quality Assurance Manager role within the Advice Compliance function which aims to enhance quality and consistency of process and outcomes across advice compliance, including audit, remuneration and disputes;⁴⁵
- viii. ongoing improvements to the central adviser data management system (**AKM**) and to the functionality of the AKM itself;⁴⁶
- ix. the introduction in 2017 of financial adviser profiling, requiring mandatory updates on a minimum annual basis to provide a more accurate picture of potential operational risks financial advisers present;⁴⁷
- x. the improvement from April 2017 of record-keeping standards requiring all documents to be kept electronically, adhering to specific format requirements;⁴⁸
- xi. the introduction of a dedicated monitoring and supervision project team (the M&S Project), the mandate of which is to implement changes to align the advice framework with the recommendations outlined in ASIC Report 515;⁴⁹
- xii. the introduction of the Key Risk Indicators (**KRIs**).⁵⁰ In that regard, there is evidence before the Commission in the document entitled “Management’s Response to Update from Customer Advocate, Wealth” (November 2017)⁵¹ that “uplift is required” in respect of monitoring and supervision of financial advisers “including greater use of technology”. As that document records, NAB supports the development of modern detective controls and use of data analytics via “Key Risk Indicators” (**KRIs**) which assist in adequately monitoring the quality of advice provided by employees and authorised representatives, including by enabling targeted file selection and themed

⁴³ Hagger Statement 2 at [66].

⁴⁴ Hagger Statement 2 at [66], [102].

⁴⁵ Hagger Statement 2 at [70].

⁴⁶ Hagger Statement 2 at [72].

⁴⁷ Hagger Statement 2 at [74].

⁴⁸ Hagger Statement 2 at [75].

⁴⁹ Hagger Statement 2 at [76].

⁵⁰ Hagger Statement 2 at [77].

⁵¹ Exhibit 2.192, NAB.005.218.0001.

advice reviews. Management noted that the “ongoing importance of evolving controls driven by systems and automation will enable a reduction in the reliance on complaints to uncover poor advice.”⁵² It went on to note that actions were in place to “uplift the control environment in regards to critical controls during FY18 ... with the aim to have automated or system based controls where practicable with a view to a strengthened control environment”;⁵³

- c. improved recruitment and screening mechanisms⁵⁴ (which are detailed further in answer to Question 1 arising from the Henderson and Dover case studies in Case Study 5 at paragraphs 80 to 81 below);
- d. the use of the Whistleblower Policy;⁵⁵ and
- e. the introduction of the Controls Transformation Program (CTP) which included the implementation of the key functionality within RiskSmart which is the enterprise wide operational risk and compliance system.⁵⁶

49 **Question 3:** *How should financial services licensees ensure that customers of their authorised representatives are adequately protected while the licensee investigates the conduct of the authorised representative?*

50 **NAB’s response:** The answer to this question depends on the circumstances of a particular case. Nevertheless, NAB considers that the following steps ought to be considered with a view to ensuring that clients are adequately protected while a licensee investigates the conduct of an authorised representative:

- a. a requirement and ability (through immediate access to client records) to identify and, in appropriate cases, alert potentially affected clients in a timely manner to possible concerns about the financial adviser and invite contact with the client (particularly where the conduct involves suspected fraud);
- b. the provision to affected clients of a dedicated contact representative whose role is to provide regular updates to the clients throughout the investigation and to educate the clients on the remediation process that may evolve from the investigation; and
- c. depending on the circumstances of the case, the suspension of the authorised representative.

⁵² Exhibit 2.192, NAB.005.218.0001 at .0002.

⁵³ Exhibit 2.192, NAB.005.218.0001 at .0002.

⁵⁴ Hagger Statement 2 at [81]-[84].

⁵⁵ Hagger Statement 2 at [85]-[90].

⁵⁶ Hagger Statement 2 at [92].

51 NAB undertakes each of the above steps with a view to seeking to ensure clients are adequately protected. In particular, the steps NAB takes include:

- a. in respect of the ability to identify potentially affected clients, NAB has in place wealth management software (XPLAN) which operates as a central depository of clients records with an audit trail. NAB financial advisers are required to use XPLAN;⁵⁷
- b. since 2015, NAB has established and utilised the Customer Response Initiative (the **CRI**), an initiative which works to identify, alert and remediate clients at risk of loss due to inappropriate advice. Under the CRI, NAB provides affected clients with a dedicated contact representative who provides clients with regular updates on the status of the investigation into the financial adviser and assists and educates the clients through the remediation process;⁵⁸
- c. the use of a client contact policy ensuring all clients who complain are contacted by phone throughout the investigation and dispute resolution process;
- d. increasing the monitoring and supervision of the financial adviser the subject of the investigation should he or she be continuing to provide advice throughout that investigation; and
- e. the ability to suspend a financial adviser pending investigation.⁵⁹

52 Other measures which NAB intends to implement to ensure that clients of their authorised representatives are adequately protected while the licensee investigates the conduct of the authorised representative include:

- a. vetting the advice provided by a financial adviser who is being investigated before it is provided to clients; and
- b. enhancing monitoring and supervision by providing targeted checkpoints where a licensee conducts a review to ensure the financial adviser is providing appropriate advice.

53 **Question 4:** *Taking into account that it may never be possible to reduce the risk to zero, what is an acceptable level of risk that clients will be provided with inappropriate advice?*

54 **NAB's response:** In determining what is an acceptable level of risk that clients will be provided with inappropriate advice (noting that it will never be possible to reduce the risk to

⁵⁷ Hagger Statement 2 at [65]-[66].

⁵⁸ Hagger Statement 2 at [38], [68].

⁵⁹ For example, Mr Bradley Meyn was suspended in November 2016 pending the completion of NAB's investigation, see Hagger Statement 1 at [130].

zero), NAB respectfully adopts the observations made by the Commissioner in the context of this question, namely that an acceptable level of risk cannot be determined in isolation but must pay due regard to the identification, investigation and remediation of inappropriate advice.⁶⁰ All of these elements must be considered as a whole in determining the level of risk of inappropriate advice.

55 In addition, NAB considers the controls it has in place to mitigate risk and ensure advice is appropriate are relevant in determining the level of risk. Indeed, that is the tenor of Mr Hagger's evidence in Hagger Statement 2 at [108] where he states that he does not "believe it is possible for NAB or GWM, or any other organisation, to put in place a system of controls that is 100% effective in preventing the risk of inappropriate advice."⁶¹ However, he goes on at [109] to note that he is satisfied that NAB and GWM have taken a "range of measures to reduce substantially the risk that financial advisers provided on behalf of NAB or GWM (or an authorised representative of NAB or GWM) will provide inappropriate advice". The measures Mr Hagger referred to are set out in response to questions 2 and 5 he was asked in Rubric 2-21 and in Annexures A and B to his statement, and which have been referred to in these submissions elsewhere, in particular paragraph 48.

Questions arising from the AMP (and related entities) case study

56 **Question 1:** *What is an acceptable period of time after identifying that a client has been or may have been provided with inappropriate financial advice to inform the client of that fact?*

57 **Question 2:** *What is an acceptable period of time after identifying that a client has been or may have been provided with inappropriate financial advice to remediate the client for any losses suffered?*

58 **NAB's response:** NAB provides the following response to both questions 1 and 2 above.

59 NAB does not consider it is possible to answer either of these questions by reference to a fixed period of time. Rather, it considers that an acceptable period of time to inform a client of inappropriate advice, and to remediate a client for any losses suffered, is dependent on the particular circumstances of the client and the advice at issue. There may be circumstances, for example, where it is not appropriate to immediately inform a client of an investigation as this could create unnecessary alarm, or the alerting of clients could possibly jeopardise an investigation.

⁶⁰ Counsel Assisting's closing address at T1969.37-42.

⁶¹ For completeness, NAB notes that other witness statements also provide similar evidence, including WBC.900.001.0179, Statement of Michael Wright dated 5 April 2018 tendered as Exhibit 2.101 at [208]; ANZ.999.003.0001, Statement of Kylie Rixon dated 9 April 2018 with Exhibit KR-1 tendered as Exhibit 2.152 at [159]-[163]; AMP.6000.0063.2957, Statement of Anthony Regan dated 11 April 2018 with Exhibit AGR-2 tendered as Exhibit 2.171 at [124].

- 60 Nevertheless, that period of time ought be one that conforms to community standards and expectations. Those community standards and expectations include the ability to quickly detect inappropriate advice through the use of sophisticated automated systems, as well as the ability to remediate clients as soon as practicable once it has been confirmed that inappropriate advice has been given (noting that it may take some time, and client cooperation, to quantify any losses suffered).⁶²
- 61 NAB has progressively enhanced their systems of policies, processes and controls to increase substantially the possibility that inappropriate advice will be identified and remedied in a timeframe that conforms to community standards and expectations, through the range of measures mentioned in paragraph 55 above.⁶³ One such measure that is worth noting in the context of this question is the CRI. This initiative was the subject of an ASIC commitment.⁶⁴ To date, NAB has invested \$49 million on the program (excluding compensation), to ensure that it remediates clients in accordance with community expectations, including expectations with respect to the timing of remediation.⁶⁵
- 62 Matters such as how best to utilise technology, how best to implement KRIs, and how best to align with regulators and professional associations to work to protect clients from inappropriate advice and inform them as soon as practicable – in addition to the complexity of the case and the requirement to provide the financial adviser with procedural fairness – play into determining what is an acceptable period of time, after identifying that a client has been or may have been provided with inappropriate advice, to remediate the client for any losses suffered. Because of those complexities, in NAB's submission it is difficult to state or quantify definitively what constitutes an "acceptable period of time." Such an assessment is inevitably case-dependent.

Questions arising from the NAB case study

- 63 **Question 1:** *How should financial services licensees balance the need to ensure that employees are held responsible for misconduct against the risk that punishing poor behaviour will encourage employees to conceal that behaviour?*
- 64 **NAB's response:** NAB considers that there are two competing considerations: on the one hand, there is a need to deter misconduct and achieve cultural change through consequences (which the community expects); and on the other, there is always a risk that imposing consequences for poor behaviour may lead employees to conceal that behaviour. These competing considerations are most appropriately addressed by ensuring the consequences imposed on employees are proportionate in the circumstances.

⁶² Hagger Statement 2 at [110].

⁶³ Hagger Statement 2 at [110] and Annexures A and B.

⁶⁴ Hagger Statement 2 at [68].

⁶⁵ Hagger Statement 2 at [104].

- 65 An example of a proportionate imposition of consequences in response to improper conduct is shown by NAB's response to the conduct of Mr Meyn and the wider conduct of NAB financial advisers with respect to the incorrect witnessing of beneficiary nomination forms.⁶⁶
- 66 The conduct of Mr Meyn included not only procuring the false witnessing of the nomination forms but also falsely initialling the forms as if he were the two clients.⁶⁷ That additional conduct justified the termination of Mr Meyn.⁶⁸
- 67 Insofar as the wider cohort of affected financial advisers and other NAB staff were concerned, NAB's specific case study submissions set out the conduct gate and remuneration consequences imposed upon financial advisers, staff and senior managers. Notwithstanding concerns expressed by Mr Steele and Mr Miller with respect to the risks of reducing the short term incentives of senior managers, including the risk of deterring disclosure, NAB submits that the decision of Mr Hagger led to reductions that were correct and proportionate.⁶⁹
- 68 It is also relevant to note in response to this question that, in the context of the beneficiary nominations issue, NAB offered a termination amnesty to those financial advisers and support staff who self-reported in respect of the incorrect witnessing of beneficiary nomination forms.⁷⁰ This offer encouraged financial advisers who had engaged in misconduct associated with the witnessing of beneficiary nomination forms to report that conduct, as opposed to concealing it, while also "bringing to the surface" the issue so that NAB could reassure the affected clients that the issue was being addressed as expeditiously as possible.⁷¹
- 69 **Question 2:** *How should financial services licensees recognise and reward ethical conduct by financial advisers?*
- 70 **NAB's response:** NAB considers that ethical conduct by financial advisers should be recognised and rewarded, including through means other than remuneration.
- 71 Proactively managing risk and compliance and customer focused behaviours form key parts of NAB's performance indicators for employed financial advisers. Alignment with NAB's Enterprise Values (which include "Passion for People" and "Do The Right Thing") is also relevant to the assessment of performance outcomes for employed financial advisers.

⁶⁶ Hagger Statement 1 at [125]-[142].

⁶⁷ Hagger Statement 1 at [127]-[129].

⁶⁸ Hagger Statement 1 at [132].

⁶⁹ Hagger XXN at T1696.40-T1699.6.

⁷⁰ Hagger XXN at T1691.4-7.

⁷¹ Hagger XXN at T1691.4-8.

72 NAB also recognises and rewards ethical conduct through its Enterprise Recognition Program for its employed financial advisers known as “NAB Recognise” and its “Quality Advice Awards”. NAB Recognise is a peer-to-peer program that recognises and rewards those who role model NAB values. Nominees receive email recognition, acknowledgement on NAB’s Recognition Wall or points to accrue or to redeem a range of reward items. NAB’s Quality Advice Awards is another peer-to-peer program (it has been piloted in Victoria and is to be rolled out Australia wide) that recognises and rewards financial advisers on a quarterly basis who have delivered high quality advice and an exceptional customer experience and outcome. Winners are rewarded by being recognised by senior leaders within the business, by email and at Professional Development Days. They are also provided with the opportunity to attend the Financial Planning Association (**FPA**) conference at NAB’s cost.

73 An example of how ethical conduct can be rewarded and recognised through means other than remuneration is NAB’s response to the leadership shown by Mr Steele, who joined NAB in April 2016, in response to the incorrect witnessing of beneficiary nomination forms. As Mr Hagger described in his evidence, NAB was “delighted” with Mr Steele’s leadership in respect of this issue “because he didn’t waver in going through the client remediation process and made it clear to employees that it was the wrong behaviour and how it should be done”.⁷² Mr Hagger explained:⁷³

I want to see issues surfaced, customers protected, and consequences. And the fact that that may impact a multiple in one year... that actually sets up, I think, leaders for success going forward, because they’ve done the right thing. They might have a reduced multiple one year, but I would say Mr Steele’s stocks rose in our organisation by his leadership of this matter. And that’s probably self-evident by the fact that he now reports directly to me and is on my leadership team.

74 **Question 3:** *Are there particular characteristics of the financial advice industry which lead to there being a higher incidence of improper, unethical or dishonest conduct than in other industries? If so, what should be done to address that issue?*

75 **NAB’s response:** NAB submits that there is insufficient evidence presently before the Commission to enable an answer to be given to the question posed. Before the question could be answered meaningfully, there would need to be evidence of a comparator industry or industries. No such evidence is before the Commission.

76 That identified difficulty is not to say that NAB is not aware of, and does not appreciate, the significant consequences for clients should they be the victim of improper, unethical or dishonest conduct. NAB is acutely aware that a relationship between a financial adviser and

⁷² Hagger XXN at T1698.3-8.

⁷³ Hagger XXN at T1698.26-32.

their client is one in which the client entrusts the financial adviser with their personal financial information and places their trust and confidence in the financial adviser to provide professional advice that serves their best interests. As a result, the financial adviser occupies a position that has the potential to be misused in an improper, unethical or dishonest way.

- 77 These matters, *inter alia*, explain why NAB has implemented and continues to implement a range of measures and controls to prevent, detect and remedy improper, unethical or dishonest conduct by financial advisers. These measures include improved recruitment and screening mechanisms, obligations to report dishonest conduct, enhanced monitoring, supervision and training of financial advisers, the CTP, the reporting of misconduct to ASIC, the appointment of Deloitte to review and report on the progress of the NAB Wealth Advice business in the context of a Quality Advice Framework, support by NAB of higher education and professional standards across the industry, the appointment of the Independent Customer Advocate, as well as a range of measures to remediate clients when improper, unethical or dishonest conduct occurs.⁷⁴
- 78 In recent years, NAB has made culture and ethics a key emphasis particularly as it relates to client centricity, living the NAB values and embedding a sense of social purpose throughout the business.⁷⁵

⁷⁴ Hagger Statement 1 at [31]-[80].

⁷⁵ Hagger Statement 1 at [75].

E. CASE STUDY 5 – THE DISCIPLINARY REGIME FOR THE FINANCIAL ADVICE PROFESSION

Questions arising from the Henderson and Dover case studies

79 **Question 1:** *Are the steps required by the ABA reference checking and information sharing protocol adequate to protect the public when financial advisers transfer between licensees?*

80 **NAB's response:** The recruitment and screening processes NAB utilises includes implementing the steps required by the ABA reference checking and information sharing protocol (**ABA Protocol**)⁷⁶, but NAB has also implemented a proactive reference checking system for financial advisers identified as a compliance concern. If such a financial adviser departs NAB and their new licensee (where known at that time) does not request a reference check, NAB proactively offers that licensee a reference check subject to the financial adviser's consent.⁷⁷

81 Further, NAB's management supports improvements in reference checking beyond the ABA Protocol, including expanding reference checking requirements to all licensees, not only ABA members. In the document entitled "Management's Response to Update from Customer Advocate, Wealth" (November 2017)⁷⁸, NAB's management noted "where advisers of compliance concern are departing the licensee, more is required to accelerate adviser consequence management outcomes and appropriate customer community. There has been a significant focus on driving uplift in processes and a cultural shift in this area with the introduction of the ABA Reference Checking protocol since March 2017, our commitment to reporting the departure of advisers of concern to ASIC and in recent months a significant lowering of tolerance of advisers remaining with the licensee during transition periods where we have compliance concerns". It is further noted that the ASIC Register of Financial Advisers is an important tool indicating whether a financial adviser has been subject to "regulatory discipline".⁷⁹

82 **Question 2:** *Should licensees be required to maintain a minimum degree of satisfaction as to the competence and integrity of applicants to become authorised representatives before authorising? If so, what form should that requirement take, and what minimum levels should be set?*

83 **NAB's response:** NAB considers that licensees should be required to maintain a minimum degree of satisfaction as to the competence and integrity of applicants to become authorised representatives before authorising.

⁷⁶ Hagger Statement 1 at [34]-[38].

⁷⁷ See also Hagger Statement 2 at [81]-[84] where he gives further evidence about NAB's implementation of the ABA Protocol.

⁷⁸ Exhibit 2.192, NAB.005.218.0001.

⁷⁹ Hagger XXN at T1672.18-28.

- 84 In respect of the minimum level of integrity, NAB considers that an application to become an authorised representative must at least pass the due diligence requirements that are set out in NAB's Advice Compliance Policy Guide section 5.⁸⁰ That policy requires that a probity check be undertaken in respect of such an application which includes an identity check, an entitlement to work check, a review of the ASIC Banned & Disqualified Persons Register, an anti-money laundering check, a bankruptcy check, a criminal record check, the ABA Protocol reference checks, a media and social media check, a review of the applicant's CV including their 10 year employment history, a review of their qualifications and professional memberships as well as a review of the FPA's "Professional Accountability and Outcomes" documents which lists all FPA members who have acted outside the FPA Constitution.⁸¹
- 85 In respect of the minimum level of competence, NAB requires that all new financial adviser recruits hold or be completing relevant higher education at Advanced Diploma level or above (in addition to a minimum financial planning qualification as set out in ASIC's Regulatory Guide 146 or higher).

Questions arising from the ASIC case study

- 86 **Question 1:** *Are the general obligations set out in section 912A of the Corporations Act expressed at too high a level of generality to be capable of being effectively enforced? What alternative obligations would be more appropriate?*
- 87 **NAB's response:** NAB is of the view that this question is one worthy of close consideration. It acknowledges the evidence given by Mr Kell (ASIC) that no pecuniary penalty is attached to the provision and that ASIC's experience with this provision has "not been typically a straightforward way of obtaining remediation in the past".⁸² Ms Macaulay (also of ASIC) also gave some evidence that ASIC did not propose to test "where the bounds of [section] 912A ... would be set by a Court" and rather would "seek to agitate for some law reform".⁸³ However, given the generality of that evidence, it is not sufficiently detailed so as to enable a meaningful answer to be given to the question posed. This question also raises complex questions of policy, and law, which require further investigation and industry-wide consultation. Matters including the following would need to be considered:
- a. ASIC's and professional associations' experience with the regulation and enforcement of section 912A;
 - b. judicial consideration of the scope of section 912A;

⁸⁰ Hagger Statement 2, tab 24, NAB.061.003.6897.

⁸¹ See part 5 in particular, Hagger Statement 2, tab 24, NAB.061.003.6897.

⁸² Kell XXN at T1035.43-46.

⁸³ Macaulay XXN at T1907.25-32.

- c. whether client outcomes would be improved or worsened by changes to section 912A;
- d. the experience in other jurisdictions (for example, the United Kingdom) of comparable provisions and alternative provisions; and
- e. the ability of banks and other financial services organisations to comply with any proposed alternative to section 912A.

88 **Question 2:** *Is the current division of responsibility for professional discipline of financial advisers between employers, ASIC and professional associations operating effectively to ensure that financial advisers face appropriate consequences for breaching their statutory and professional obligations?*

89 **Question 3:** *Does that division of responsibility create gaps in the disciplinary system? If so, what are they?*

90 **NAB's response:** NAB provides the following response to Questions 2 and 3.

91 The division of responsibility for professional discipline of financial advisers was the subject of direct evidence of Mr Hagger in the context of Case Study 4.

92 In response to a question as to why NAB did not report the conduct of financial adviser Mr Meyn to the FPA, Mr Hagger gave evidence of his understanding of the division of responsibility for professional discipline of financial advisers between employers, ASIC and professional associations. As he said, of these “three limbs”, the employing bank is responsible for the “employment discipline”, ASIC is responsible for the “regulatory discipline” and professional associations such as the FPA carry out the “professional association discipline”.⁸⁴ In his view, the “two key areas are the employment discipline and the regulatory discipline”, although he noted that he had also had discussions with NAB's Independent Customer Advocate, Professor Kingsford Smith (who was formerly the Chair of the Conduct Review Committee of the FPA), to understand how the “professional association discipline” limb could be utilised more frequently in the future.⁸⁵

93 When asked why he did not consider the “professional association discipline [to be] a key area”, Mr Hagger explained that it was his understanding that the FPA does not have the same levels of power in its mechanisms as ASIC or the institution at which a planner is employed.⁸⁶ He also noted that while NAB requires its financial advisers to be a member of a professional association, a financial adviser can choose to exit one professional

⁸⁴ Hagger XXN at T1671.5-17.

⁸⁵ Hagger XXN at T1671.1-17.

⁸⁶ Hagger XXN at T1671.19-31.

association in preference for another and, even if one professional association expels a financial adviser, there was nothing preventing that financial adviser joining a different association.⁸⁷ This difficulty should not, however, be overstated because, as Mr Hagger also noted, the ASIC Financial Advisers Register operates across the industry and irrespective of a financial adviser's professional association membership.⁸⁸

94 The question of whether these three limbs are working harmoniously (including without gaps) and effectively is, in NAB's submission, worthy of close consideration. However, the question raises complex questions of policy and further analysis and industry consultation is required to properly assess these issues. Before the questions can be answered meaningfully, matters including the following would need to be considered:

- a. a precise analysis of what in fact constitutes the current division of responsibility for the professional discipline of financial advisers between employers, ASIC and professional associations;
- b. whether professional associations have sufficient powers to effectively discipline financial advisers and, if not, what powers they require to be effective and improve client outcomes;
- c. an investigation into the optimal structure for a professional association and how that structure would balance the interests of members with any disciplinary functions and the desire to improve client outcomes; and
- d. the experience in other jurisdictions of professional associations for financial advisers, the nature and effectiveness of their powers, and the inter-relationships between employers, regulators and professional bodies in those jurisdictions.

95 **Question 4:** *Is it possible to implement a single system for professional discipline of financial advisers? Would structural changes to the financial advice industry be required to bring that about? Would a system of licensing at both an individual and an entity level be more appropriate than the existing system of licensing only at the entity level?*

96 **Question 5:** *Is there a particular regulatory culture that has developed in relation to the regulation of the financial advice industry? What is that culture and what has contributed to its development?*

97 **Question 6:** *Has the existing regulatory culture in the financial advice industry contributed to the occurrence of misconduct in the financial advice industry? What changes in regulatory culture might assist in reducing the incidence of misconduct in the financial advice industry?*

⁸⁷ Hagger XXN at T1671.31-35.

⁸⁸ Hagger XXN at T1672.23-28.

98 **NAB's response:** NAB provides the following response to Questions 4 to 6.

99 NAB is of the view that questions 4 to 6 are worthy of close consideration and NAB acknowledges the relevance and importance of ASIC's views on these questions. However, there is insufficient evidence presently before the Commission to enable answers to be given to the questions posed. Before these questions can be answered meaningfully, matters including the following would need to be considered:

- a. the experience in other jurisdictions where there is a single system for professional discipline and whether that system improves client outcomes in those jurisdictions;
- b. the different models as to what a single system for professional discipline may look like and the features, advantages and disadvantages of those systems;
- c. what structural changes to the financial advice industry are appropriate and how those changes may be implemented and over what timeframes;
- d. the various aspects of the regulatory culture that currently exist (for example, the different enforcement mechanisms utilised by ASIC such as a negotiated enforceable outcome and litigation) including an analysis of how those aspects have positively and/or negatively impacted on incidents of misconduct in the financial advice industry; and
- e. a detailed analysis, including by reference to whole of industry views, of what regulatory culture does exist, how regulatory efforts and resources are applied across different layers within the financial planning industry (from the smallest licensees through to the large institutions) and any impacts on customer outcomes and the behaviour of licensees and financial advisers.

F. CASE STUDY 6 – VERTICAL INTEGRATION

100 **Question 1:** *Can financial advisers effectively manage the conflicts of interest associated with providing advice as a representative of an institution that also manufactures financial products? Is it necessary to enforce the separation of products and advice?*

101 **NAB's response:** As was noted in answer to Question 1 arising from Case Study 2, NAB considers that financial advisers can effectively manage the conflicts of interest associated with providing advice as a representative of an institution that is part of a group of companies that also manufactures financial products. It is not necessary to enforce the separation of products and advice so long as conflicts of interest are appropriately managed.

102 NAB repeats its submissions set out in response to Question 1 arising from Case Study 2 and notes the following additional matters.

103 There is evidence of the guidance documents and tools that NAB already has in place to effectively manage conflicts of interest associated with providing advice as a representative of an institution that is part of a group of companies that also manufactures financial products. This includes the processes and procedures adopted by NAB to manage conflicts of interest in connection with decisions by employed financial advisers and authorised representatives of NAB to recommend in-house products include the Licensee Conflict of Interest Standard, the Conflicts of Interest Policy and the Conflicts Priority Rule⁸⁹. The latter provides that where there is a benefit to the licensee or related entities of the licensees in recommending a particular financial product, the financial adviser must give priority to the interests of the client.⁹⁰ Thus, where a product manufactured by a NAB Group entity is recommended it must be better for the client than the client's existing product and at least comparable to similar alternative products in the market, such as the one selected for comparison.⁹¹

104 In addition, NAB has put in place the following processes and procedures (among others) to manage conflicts of interests in connection with decisions made by its Advice and Licences Investment Committee (**ALIC**) when it approves products for inclusion on an approved investment list (being the list of products which financial advisers are permitted to recommend to clients without seeking any further approvals):⁹²

- a. recommendations are made to ALIC by ThreeSixty Research (**ThreeSixty**) following a research and review process. ThreeSixty operates separately from NAB's investment product, platforms and insurance business units. This separation is reflected in reporting lines, physical location of the ThreeSixty team and information barriers;
- b. ThreeSixty subjects NAB Group products to the same review and monitoring processes as externally manufactured products;
- c. ThreeSixty uses external research ratings (where available) in addition to its own review processes;
- d. every recommendation to ALIC (or its Sub-Committee) in relation to a NAB Group product has a stated response in relation to any conflict of interest and confirms how that issues has been taken into account in the recommendation; and

⁸⁹ Barnwell Statement at [71]-[74].

⁹⁰ Barnwell Statement at [73].

⁹¹ Barnwell Statement at [73].

⁹² Barnwell Statement at [19] and [54].

- e. ALIC (and its Sub-Committee) both include non-executive directors as members and decisions of ALIC (and its Sub-Committee) in respect of NAB Group products require the approval of a majority of non-executive members present.

105 **Question 2:** *Should the statutory carve-outs to the ban on conflicted remuneration, including the recent carve-out in relation to insurance commissions, be maintained. If so why?*

106 **NAB's response:** The application of the statutory carve-outs on the ban on conflicted remuneration within NAB (i.e. the "Permitted Benefits" offered) are outlined in detail in the Barnwell Statement.⁹³

107 NAB considers that there is insufficient evidence before the Commission to make a definitive recommendation as to whether each of the statutory carve-outs to the ban on conflicted remuneration (i.e. each of the "Permitted Benefits") ought be maintained.⁹⁴ There are important policy and practical reasons underpinning certain of the statutory carve-outs for conflicted remuneration. By way of example only, NAB considers that the statutory carve-outs contained in sections 963B(1)(d)(ii) and 963B(1)(e)(ii) of the *Corporations Act 2001* (Cth) – namely a monetary or a non-monetary benefit that is given by a client for the provision of advice given by the licensee or its representative – are necessary as they ensure that a fee for service model can be adopted by those licensees or their authorised representative. Indeed, as explained at paragraph 12 above, NAB FP has in recent years made the shift from a commission based financial adviser remuneration structure to a fee for service model.

108 Nevertheless, NAB appreciates that it is important to have close regard to whether the policy reasons underpinning the remaining statutory carve-outs to the ban on conflicted remuneration have sufficient force to justify the maintenance of the carve-outs. In that regard, NAB considers that there would be utility in a post-implementation review of the carve-outs in order to analyse whether the policy reasons underpinning them remain valid.

109 NAB considers that it is premature for it to express a view as to whether the statutory carve-outs in relation to insurance commissions ought be maintained. The reforms in life insurance have recently been reviewed comprehensively by Parliament which has had to weigh the risk of underinsurance with the need to reduce other poor client outcomes. The life insurance reforms (including the statutory carve-out in relation to insurance commissions) are significant and only came into effect in January 2018.⁹⁵ In those

⁹³ In particular, see Barnwell Statement at [89]-[92].

⁹⁴ Save for those addressed in Section A above.

⁹⁵ The *Corporations Amendment (Life Insurance Remuneration Arrangements) Act 2017* commenced on 1 January 2018 and amended the *Corporations Act 2001* (Cth) to allow commissions to be paid for the sale of life insurance. The ASIC Corporations (Life Insurance Commissions) Instrument 2017/510 sets limits on the commissions through a commission cap.

circumstances, NAB's position is that the industry ought be given some time to work through the reforms. Further, ASIC's post-implementation review of the reforms will be informative of the question of whether that carve-out ought be maintained.⁹⁶

7 MAY 2018

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⁹⁶ ASIC Report 527: "Response to submissions on CP 245 Retail life insurance advice reforms" (June 2017), page 6 states that the ASIC review of the reforms will commence in 2021.