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

SUBMISSIONS OF THE FINANCE SECTOR UNION IN RELATION TO THE FINANCIAL ADVICE ROUND OF CASE STUDIES

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A Outline of submissions

1. These submissions deal with the second round of case studies.

2. The second round of case studies has again highlighted that the behaviour of individuals in our largest financial institutions is instructed by a preference for profit over customer interest. Control mechanisms such as bonuses, individual incentives, targeted driven performance management and disciplinary action all direct behaviour towards the sale of financial products and services that are designed to create revenue for the organisation. Such a culture is anathema to customer outcomes and community expectations. This culture has eroded and continues to erode the privileged position of trust financial institutions hold.

3. The Union identifies the following themes in these submissions:

   (a) Financial institutions controlling or attempting to control employee and adviser behaviours through individual incentives, bonuses and targets leads to behaviour which is antithetical to consumer interests. Financial institutions' focus should be on establishing the right culture. The right culture includes ensuring that the institutions and the actors within them always act in the best interests of the customers, and that the terms and conditions of staff engagement are fair and supportive of this culture.

   (b) The current system of regulation is insufficient and inadequate. Regulation should hold licensees, product manufacturers and senior managers accountable for their behaviour. Regulation should also impose licensing and minimum standards on financial advisers.

   (c) A contention that financial advice, or the financial services sector generally attracts the wrong kind of people is ill conceived and without basis.

   (d) The solutions to the issues faced in relation to financial advice do not lie in technology and automated decisions. The solutions lie in the professionalisation of the industry.

4. Parts B and C of these submissions deal with the two central issues of culture and regulation for financial advisers.

5. Parts D to J respond directly to the questions posed by Senior Counsel Assisting in respect of the various case studies considered by the Commission in the hearings between 14 and 27 April 2018. In each case, we have reproduced the question and provided the Union's submission on it.

B The Central issue of Culture

6. Culture is the "*collective assumptions, values, norms, beliefs and expectations that shape how people behave*".[1] Along with regulation, culture is a central driver of behavior within financial institutions. Culture is integral to the relationship of employees to their employers and their customers within the financial services sector.

7. The evidence seen by the Commission indicates that senior leaders within financial institutions have a critical role in setting the culture of an organisation.[2] Depending on the priorities of the senior leaders, this can work in favour of customers and employees, or against them. In his evidence, Mr Hagger noted that the culture within the NAB Wealth Advice business had been "adviser centric" (read "revenue centric") but was moving towards a more "customer-centric" culture.[3]

8. This leads to the question of why this culture has changed. The evidence heard by the Commission indicates that where there have been systemic failures which negatively impact customers, they are generally underpinned by a culture that prioritises profit over the customers' interests. The Union suggests that financial institutions have encouraged, explicitly and implicitly, the development of this culture in order to maximise profit.

9. While the Commission has heard that financial institutions intend to shift their culture to focus on customer outcomes, it is important to note that cultural change is a complex process. This is particularly the case in these organisations which are large and subject to complex regulatory regimes.

10. This complexity is exacerbated by the interaction between law or regulation and culture. While much has been written about the sources of law and culture, a key question is whether law and regulation arise from the dominant culture, or whether law and regulation determine the culture.[4]

11. The Union submits that in practice, the relationship between law or regulation and culture is circular – culture provides conditions in which law and regulations are created, which in turn act upon the culture.[5] The consequence of this is that any attempt to improve culture in banking must also address the questions of regulation. It is the Union's view that it is not possible to change culture without also creating a supportive regulatory framework. The Union contemplates the question of this regulatory framework at Part C of its submissions.

12. For financial institutions to return to a place of community and employee trust and respect, they must address the cultural issues that have been identified in the course of the Royal Commission. Part of this is taking an expansive view of what constitutes culture, and what can be attributed to culture. In his evidence, Mr Hagger characterised the beneficiary nomination issue as a "failure

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[1] Cotterell, A "A good culture is about more than ensuring good people don't do bad things – it's about enabling good people to do better things" in Financial Conduct Authority, Transforming Culture in Financial Services - Discussion Paper DP18/2, March 2018 at page 21.

[2] T1694.15-16.

[3] T1694.19-20.

[4] Menachem Mautner, "Three Approaches to Law and Culture" (2011) 96 *Cornell Law Review* 839, 850.

[5] Menachem Mautner, "Three Approaches to Law and Culture" (2011) 96 *Cornell Law Review* 839, 856.

of discipline".[6] The Union respectfully agrees with Ms Orr's alternate characterisation of this issue as a "failure of culture at NAB".[7] Mr Hagger is correct in stating that incorrect practices became a "social norm" which became "entrenched" at NAB.[8] However, the reasons for this were that NAB created a culture through reward, discipline and training procedures which left staff with few options other than to act in this way.

13. The failures identified by the Royal Commission to date are largely attributable to a failure of culture – be that reflected in recruitment practices, insufficient training and development practices, the imposition of targets on employees, prioritisation of incentive and commission-based payments over salaries, cutting staff who perform compliance and administrative functions, the undervaluing of compliance, and the focus on revenue over service.

14. The primary driver of culture in financial institutions is the leadership of the directors, bank executives and managers. Policies and procedures such as sales driven performance incentives drive the behaviours of those who deal with consumers whether they be direct employees or others who act ultimately on behalf of the financial institutions such as financial advisers and brokers. The cultural failure in financial institutions is reflected in this bias towards sales over service, and of profits and revenue over the interests of customers. For employees of financial institutions, this cultural failure impacts their daily working lives.

15. The Union submits that finance workers are negatively impacted by poor culture in financial institutions on a daily basis. The vast majority of finance workers are dedicated to providing excellent service to their customers, and acting in the best interests of their customers. However, finance workers regularly feel that there are pressures from their employer which deprioritise the interests of the customer.

16. It is the Union's experience that this conflict between complying with financial institution culture and doing what is best for the customer causes significant stress to finance workers. Finance workers are aware that to maintain their employment, they must act in accordance with the dominant culture of the organisation. This is most frequently demonstrated through meeting sales and other financial targets. The majority of finance workers have a strong preference to prioritise acting in the best interests of their customer, but feel that this is potentially inconsistent with maintaining their employment.

17. A further example of this is found in APRA's Final Report of the Prudential Inquiry into the Commonwealth Bank of Australia (CBA) released on 30 April 2018.[9] The report identified a series of failures in the operation of the CBA. CBA has agreed to enforceable undertakings in connection with the matters raised.

18. The failures identified by APRA each arise from cultural failure within the leadership of the CBA. An interview published by the CBA provided insight from Mr Comyn, the CEO of the CBA:

> *There are tens of thousands of people around the country who come to work every day and do a great job serving their customers. This report is not about them. This is a report about the failures of senior leadership inside the Commonwealth Bank, including me. The focus has to be on how we are going to change the leadership and the culture of the organisation, starting from the top."*[10]

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6 T1676.40-41.

7 T1677.11.

8 T1676.47 – T1677.48.

9 http://www.apra.gov.au/AboutAPRA/Documents/CBA-Prudential-Inquiry_Final-Report_30042018.pdf.

10 Commonwealth Bank of Australia, "Matt Comyn APRA Report Video Interview Transcript", 1 May 2018, https://www.commbank.com.au/guidance/newsroom/apra-report-video-transcript-201805.html?ei=card-view.

19. The Union notes that financial institutions in Australia have strongly resisted regulation. The intense debate regarding the Future of Financial Advice reforms is one such example where financial institutions opposed regulations that would increase consumer protections.[11] This illustrates both the priorities of financial institutions, and their position on regulation.

20. Financial institutions have strongly resisted regulation that may have served to better protect consumers. This was both to maintain their extant business models and to remove scrutiny from the ways in which they conduct their business. Consumers and employees have suffered as a result. It is clear that financial institutions have preferred to dedicate their resources to opposing regulation which would improve customer and employee outcomes, rather than examining their own culture.

21. While culture in banking is currently a significant factor in creating and allowing negative customer and employee outcomes, it also provides an opportunity for financial institutions. How to develop better cultures within the Australian financial services sector is both beyond the scope of these submissions and beyond the expertise of the Union. The Union submits that the Commission may wish to consider steps to require financial institutions to work with regulators, employees and customers to undertake a genuine cultural review, and implement any recommendations in good faith. As discussed in Part C below, the Union further submits that financial institutions must implement all regulation required to support a culture which prioritises customer outcomes.

C The need for Enforceable Regulation and a Financial Services Code

22. The Union submits that the Commission should consider recommending the introduction of enforceable regulations in relation to financial advice that would form part of a comprehensive Financial Services Code.

23. The Union believes the regulations dealing with financial advice should contain provisions:
    (a) for the licensing of individual financial advisers;
    (b) for required education and professional standards for financial advisers;
    (c) for standards of professional conduct of financial advisers, and disciplinary procedures for failure to meet such standards;
    (d) addressing issues arising from vertical integration;
    (e) setting expectations for the conduct of the AFSL holders in connection with the provision of financial advice;
    (f) setting expectations for the conduct of product manufacturers and platform providers in connection with the provision of financial advice;
    (g) creating a regime for senior management responsibility and accountability;
    (h) creating a system of appropriate penalties and fines available in the event relevant entities fail to meet minimum obligations; and
    (i) creating obligations and processes for consumer remediation.

24. The system of enforceable regulations for financial advice should form part of a comprehensive Financial Services Code that addresses all aspects of conduct. The code should reverse the current trend where responsibility is increasingly imposed onto those with direct customer contact (such as, in the current instance) financial advisors, and away from those with greatest capacity to determine standards, training recruitment, remuneration systems.

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[11] See, for example, Ian Verrender, “Bad Timing Asking for FoFA Wind Back” (ABC News, 7 July 2014) http://www.abc.net.au/news/2014-07-07/verrender-the-irony-around-the-fofa-fight/5575864.

25. The Union submits that the underpinning principles of the Financial Services Code should be that:
    (a) all individuals and entities have an ongoing obligation to ensure that the financial services provided to consumers are in the best interest of the consumer, and are provided in an ethical manner;
    (b) that the nature and extent of that obligation should be determined by reference to the capacity of the individual or entity. For example, the capacity of product manufacturers is clearly different to the capacity of a licensee. However, the Union submits that there should be an obligation of care imposed on each; and
    (c) the obligations should not be limited to corporate entities but should extend to the individuals that control and determine the actions of such entities. Managers and executives, to the extent they have control or influence over the conduct of entities, should be required to exercise that control or influence in a manner consistent with the best interests of the consumer.

Current system of regulation of financial advice

26. A key defect in the current system of regulation of financial advice is that the current regime is ill-defined. There are too many organisations, regulatory regimes and methods of control in play. There are controls arising from regulation; obligations to professional organisations; contractual or like obligations owed to employers; and, for Authorised Representative, obligations owed to and control by licensees. The consequence of the often competing obligations created by the current system is the absence of a clear set of obligations that drive ethical behaviour. From the outside, it appears that there are various entities and organisations responsible for ensuring good behaviour but in practice each organisation relies on the others to ensure behaviour is regulated.
27. An example of this is the clear gaps in disciplinary processes for financial advisers. It was apparent that ASIC does not believe that it is their responsibility, and in any event do not have the resources to provide an overarching regulatory function.
28. The various membership-based professional associations appear more focused on member recruitment (including as between each other) and servicing, than the disciplining of the members. The employer's response, the various Conduct Background Check Protocols are inappropriate and unsustainable. It provides no meaningful protection for consumers (who have no access to the information), and in failing to provide any procedural fairness to those adversely named, will inevitably be subject to legal challenge.
29. There are similar gaps relating to credentialing and professional standards, remediation, vertical integration, and accountability for AFSL holders and their senior management. To greater and lesser degrees, the regulation in relation to each is confused and lacking.
30. None of the witnesses (including, conspicuously ASIC) in the hearing gave evidence to the effect that the changes being introduced through the FASEA reforms were likely to resolve the issues surrounding financial advice.
31. Accordingly, the Union submits the need for the provision of strong uniform regulation in relation to each of the above matters is clear.

Comprehensive licensing framework

32. The Union submits that there is a strong need to develop a comprehensive licensing framework for financial advisers. Such a framework is a required step on the path to professionalism. The framework should bring together the qualification and educational standards work being done as part of the FASEA reforms, along with a requirement for individual licensing of financial advisers.
33. As with other professional licensing frameworks provision should be made for:

(a) promulgation of specific ethical obligations;

(b) continuing learning obligations including around professional and ethical standards; and

(c) an independent complaints and discipline process that addresses professional and ethical failures.

34. Such independent complaints and discipline process should:

(a) work as part of a disciplinary and complaints process that covers the financial services industry;

(b) cover all licensed financial advisers;

(c) have a capacity, where appropriate:

(i) to refer the complaint or issue to an employer or licensee in circumstances where the issues raised are not sufficiently serious to justify a formal disciplinary investigation;

(ii) to refer complaints or issues to a regulator for prosecution; and

(iii) to refer others involved in the matter, such as license holders or product manufacturers to an appropriate body for investigation;

(d) operate independently of employers, employer associations, member organisations or professional associations;

(e) provide financial advisers who are subject to complaints procedural fairness in connection with any complaint; and

(f) issues penalties and disciplinary action that is proportionate and reasonable.

35. The regulation should also impose obligations on licensees, manufacturers of financial services and platform providers. At a high level such obligations should ensure that they take all reasonable steps to ensure that financial advice services and products offered to customers are in the customer's best interest.

36. Such regulation should be extended to impose consistent obligations, proportionate to their capacity to effect the services and products, on senior managers.

37. The regulation should also address issues around vertical integration, APL's and platform fees. Such regulation should be expressed to impose obligations in the services and products being provided in the customer's best interest.

38. Finally, the regulation should address the issue of customer remediation including, where appropriate, penalties. The evidence to date in the Royal Commission is consistent with remediation and penalties being viewed by financial institutions as simply a cost of doing business, with no significant associated disincentive or behavioural driver.

D Fees for no service

D-1 Do clients receive any meaningful benefit from ongoing service arrangements?[12]

39. The Union understands the increased importance of ongoing service arrangements is a consequence of the FOFA changes. The Union further understands the concern that ongoing service arrangements are simply a rebranded iteration of the commission revenue eliminated by FOFA. The proposition that the quantum of the ongoing service fee is determined more by

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12 T1948.12.

reference to how much the customer used to pay in commissions, than the services they are now being provided, is clearly problematic and unacceptable.[13]

40. However, the broader proposition, that advisers should maintain an arrangement of ongoing advice and monitoring is not just sustainable, but also desirable. In most instances, clients receive meaningful benefit from such ongoing service arrangements. The issue is not about ongoing service arrangements *per se*; rather it is around the substance of the service arrangement, the cost of the service arrangement (including whether it is a fixed fee, by reference to funds under management, or by an hourly rate), the communication to clients as to what services the adviser/licensee will provide, and the method of charging clients for such arrangements.

41. Aside from customers who seek no more than a Statement of Advice, most customers require some ongoing service arrangement. Most platforms do not permit direct access by consumers, but rather require the involvement of a financial adviser.

42. As such, the ongoing service arrangements vary on a continuum from:

(a) an *ad hoc* arrangement, where the customer engages the adviser from time to time, usually billed based on an hourly rate when they seek to make a transaction or to obtain further advice,

to

(b) an ongoing arrangement, where the adviser provides ongoing services, which may include the provision of annual advice, a watching brief focused on opportunities or threats to the customer's investments. Such arrangements can be billed at an hourly rate, a fixed fee, or by reference to funds under management.

43. There is nothing inherently wrong about any of these models, or billing practices. The appropriate arrangement should be determined by the customer in consultation with the adviser.

44. The Union supports a shift to a model where the revenue to licensees / financial advisers come from service provision as opposed to trailing commissions. That fee revenue should be based on the level of service required by the client, agreed to by the client and ultimately provided to the client. Efforts to minimise the opt-in model should be rejected.

45. These general issues, which are about the development of the financial advice business model are not the same as the Fee for No Service, or fee for limited service issue considered by the Royal Commission as arising at AMP and CBA, and also considered by ASIC in its report on fees for no service.[14] The Fee for No Service issue was instead a reflection of an immature and ill-prepared response to FOFA.

46. The Union submits that the issues raised by Fee for No Service are explicable by reference to a number of factors.

47. The first factor is the shift in focus from commissions to service arrangements because of FOFA, and the delay in institutions and practitioners addressing the consequences of that shift. The fee for service model remains immature.

48. The second factor arises from remuneration, bonus and target issues within institutions.

49. Several financial institutions continue to rely on funds under management, and revenue, as a target for their employed advisers, and revenue as a measure for STI payments. Commonly STI payments are associated with "new" business and the growth of the customer base.

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13 Ex #2.1 Statement of Peter Kell at [33] (ASIC.0902.0001.3289).

14 Ex #2.1.3 ASIC Report 499 Financial Advice: Fees for No Service (ASIC.015.0003.9240).

50. This creates an incentive/obligation for employed financial advisers to accumulate as many clients as possible, without the systems or capacity to provide those clients an appropriate level of service. In the Union's experience, this fact is known and accepted by financial institutions.

51. This submission is consistent with the kind of Fee for No Service arrangement identified by Mr. Kell as most prevalent.[15]

52. This submission is also supported by the evidence of Mr. Kell as to whether financial services entities are seeking to replicate income streams that are no longer available. The Union's experience is that the effects of FOFA are to make financial advice less lucrative for financial services entities. This has, in turn, led to a reduction in staff, and an expectation, from some entities, that those staff will continue to generate revenue at pre-FOFA levels. In this context, the underservicing of customers who have ongoing service arrangements which are paid from funds under management is a clear risk.

53. The third factor is provided by insight into the how the financial advice industry works. It is not provided as exculpatory, but rather as an explanation. As noted above, a key factor of no fee or limited fee for service was where a previous financial adviser had left and a new adviser is appointed.

54. Relevant to this, from the experience of the Union, there has been a significant decline in the number of financial advisers servicing clients during that period (as well as an even greater decline in the support they receive such as through para planners),[16] with no corresponding reduction in the number of clients seeking financial advice. By way of example, the evidence of the CBA was that in the period 31 December 2008 to 31 December 2017 the number of financial advisers had fallen from 733 to 582, while the number of clients serviced by them had risen from 105,988 to 191,830. This represents a change in ratios from 1 financial adviser for each 144 clients in 2008, to 1 financial adviser for each 330 clients now.[17]

55. Financial advisers report that the process of dealing with an effect of an adviser leaving creates several issues that will increase the possibility of the customer not being provided a service or an adequate service. A number of these issues are referred to above or by ASIC in their report. The issues include:

    (a) delays in new advisers being allocated;

    (b) the organisational tendency to allocate groups of files to new advisers, or staff returning from periods of leave (such as from maternity leave) which creates a bottleneck for the new adviser to deal with;

    (c) the work involved in a new adviser taking over a customer, which generally involves conducting a file review. This process is significantly more onerous than the provision of ongoing advice to the adviser's pre-existing customers. Advisers report that employers do not allocate advisers additional time or resources to complete the process of 'getting up to speed' on a transferred customer.

56. A fourth factor is the various cultural issues identified in the ASIC Report, and in the evidence of Mr. Kell. We repeat our submissions in relation to culture above. Mr. Kell's evidence is that the entities have "*continued to prioritise advice revenue and fee generation over ensuring that they delivered the required services to customers*".[18] This has led to a corresponding prioritisation of new sales over the continued servicing of customers.

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[15] Ex #2.1 Statement of Peter Kell at [24] (ASIC.0902.0001.3288).

[16] This experience is confirmed by the evidence before the Commission as to numbers of financial planners – see for example as to ANZ T1561.41; as to CBA Ex2.74 Supplementary Statement of at Marianne Perkovic at [5] (CBA.9000.0021.0002).

[17] Ex2.74 Supplementary Statement of at Marianne Perkovic at [5] (CBA.9000.0021.0002).

[18] Ex #2.1 Statement of Peter Kell at [25] (ASIC.0902.0001.3288).

57. A fifth factor arises from the impact of the FOFA grandfathering of commissions paid on investments entered into prior to 2013. This has created an incentive on financial advisers to do nothing, which in turn has created an incentive to avoid interaction or advice to the customer which may lead to a direction to change investments.

D-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?[19]

58. The Union has limited insight on this matter and does not believe it can assist the Commission.

D-3 Should grandfathered commissions cease?[20]

59. The Union supports the move from commission-based revenue, to revenue based on service delivery. This observation is not limited to pre-2013 products that were grandfathered under the FOFA regime but extends to the commission revenue model that remains in connection with insurance products, and some superannuation and pension products.

60. Once a customer changes from a pre-2013 product to a new product, the grandfathered protection and provision of trailing commissions disappears.

61. The current grandfathering of pre-2013 products has created an incentive for advisers to provide advice to customers to do nothing, or alternatively, an incentive to not provide customers advice at all.

62. In taking a position in support of the elimination of grandfathered commissions, the Union further submits that it is not reasonable or fair for employees and advisers to bear the cost of the elimination of such revenue streams.

63. To the extent employee targets or pay models contain provision for commission-based revenue, those targets and pay models must be adjusted so as to avoid adverse impacts on the employee.

E Investment platform fees

E-4 Does vertical integration of platform operators with advice licensees serve the interests of clients? If so, how?[21]

64. In connection with vertical integration generally, the Union repeats its submission in response to Question J-28.

65. In relation to the issues related to platform operators, the Union submits that commercial transactions between product manufacturers and platform operators such as shelf based fees and volume rebates provide incentives to licensees that affect the advice being provided in circumstances where the licensee and the platform operator are vertically integrated.

66. Such arrangements are a form of conflicted benefit for the platform operator and, like all forms of conflicted remuneration, mean that the customer's best interest may be compromised.

E-5 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?[22]

67. The Union has limited insight on this matter and does not believe it can assist the Commission.

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[19] T1948.13.
[20] T1948.16.
[21] T1953.27.
[22] T1953.29.

E-6 ***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 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?***[23]

68. The Union has limited insight on this matter and does not believe it can assist the Commission.

F Inappropriate financial advice - Westpac and BT Financial Group

F-7 ***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?***[24]

69. Remuneration and incentive policies that reward financial advisers for revenue generated are conflicted remuneration. Like all conflicted remuneration policies, they create risks that the interests of consumers will be compromised.

70. The Union's experience is that employers/licensees who continue to maintain conflicted remuneration models for financial advisers and other staff who have direct customer contact also maintain and support related practices that create similar bad incentives. Such related practices include:

    (a) maintenance of revenue, or other product specific sales targets for financial advisers;

    (b) publication of ladders or other public recognition by reference to sales performance; and

    (c) revenue targets for supervisors, managers, and executives.

71. The Union submits that any model that creates a personal incentive – whether it be so as to meet minimum targets and thereby avoid performance review, or to obtain peer and management acknowledgment, or to obtain bonuses and incentives - operates to increase the possibility that the individual will not be motivated to act in the best interests of the customer.

72. Significant parts of this conflict were addressed, and minimised by the FOFA reforms.

73. However, the Union submits that the attention should be paid to those areas that operate outside the FOFA reforms including:

    (a) employment based sales and revenue targets;

    (b) conflicts created by vertical integration, and preferential supplier contract models;

    (c) pre-2013 products;

    (d) insurance and superannuation products; and

    (e) advice provided under the auspices of "general advice" as opposed to "financial advice".

74. Further, both regulation and cultural reform should focus on the elimination, and where that is not possible, minimisation of drivers that would cause the adviser to consider factors other than the best interest of the customer. As is discussed in Part C of these submissions, such regulatory

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[23] T1953.34.
[24] T1959.19.

reform should ensure that employers and others who have contractual authority over advisers are not able to use that authority so as to impose conflict.

F-8 ***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?***

75. The best and most constructive path to ensuring the provision of good quality financial advice is through the advancement of the financial services profession.

76. The Union submits that the following factors are relevant to such an approach.

(a) aligning the customer interest and the adviser interest;

(b) the elimination of incentives and drivers to act in a manner contrary to the customer interest; and

(c) the promotion of incentives and drivers to act in a manner consistent with the customer interest.

Aligning the customer interest and the adviser interest.

77. The primary focus of the adviser should be the long-term interest of the client. The aim should be making the financial services industry more professional and developing an ethical framework that is client focussed. Such an ethical framework should operate as a powerful driver of behavior and culture.

78. The Union refers generally to its submissions at Part B above in connection with culture.

79. The Union further submits that the central tenet of regulation of the financial advice industry should be the interests of the customer. Such a regulatory principle would lay a foundation for specific regulation on advisers, licensees, employers and product manufacturers (along with regulation of the senior managers and officers of such entities) prohibiting measures which incentivise contrary behaviour.

80. More specifically, such an approach involves a paradigm shift for licensees away from viewing financial advisers as sales agents of financial products, and towards a customer-centric model that prioritises the long-term financial interest of the customer. A fundamental element of other professions is that the primary obligation is to the patient/customer/client.[25] This can be contrasted with salespeople where this is not the case.

81. By way of illustration, the Union refers to the NAB Enterprise Agreement 2016 which sets out the terms and conditions of NAB employees, including NAB financial advisers. Appendix 2 of the Agreement provides for Short Term Incentive (STI) payments to financial advisers. The Agreement provides that a minimum of 70% of the STI payment should be attributable to revenue obtained by the adviser.

82. Licencees should pay their employees fairly for the work and effort expended, and not as salespeople on the basis of revenue targets and by commission.

83. Further, the Union submits that customer fee models should be based on hourly rates and unlinked to funds under management. The linking of the fees charged to funds under management creates an incentive to increase the funds under management. That incentive is removed by fee models where the adviser/licensee is paid by reference to the provision of advice. In such a situation, it seems far more likely that advice that an individual remains in their current superannuation fund, or not sell investment property and invest in managed funds, would be given when in the best interests of the customer.

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[25] That professionals also have obligations to others, such as for lawyers, obligations to the Court is acknowledged.

Elimination of incentives and drivers to act in a manner contrary to the customer interest

84. The primary incentive that drives advisers to act in a manner contrary to the customer is conflicted remuneration and employment practices. The Union uses this term beyond its narrow scope to extend to a broad range of remuneration and employment practices including:

(a) the terms of bonus and incentive payments made to managers and executives;

(b) sales and product targets;

(c) revenue targets;

(d) commission payments;

(e) promotions granted based on sales performance;

(f) performance management including disciplinary action based on revenue and sales performance;

(g) bonus payments based on sales or revenue; and

(h) bonus or supplementary payments or benefits based on the sale of specific products, or classes of product.

85. A second set of incentives arises for organisation culture and peer expectation. It has been a common feature of the industry that advisers are encouraged and motivated to make sales. While the financial incentives are a primary focus, the softer cultural and peer actions, such as publishing league tables where the "best" and "worst" sales performers are named are part of the same issue.

86. A third set of incentives arises from issues around approved product lists, and the bias inherent in vertical integration. Approved product lists limit the products that can be easily or readily recommended to the customer, and at an extreme will mean that the customer will not be advised of the product most appropriate for them. Similarly, even absent targets and commission based incentives, vertical integration is likely to be associated with greater sales within the licensee/manufacturer.

Promotion of incentives and drivers to act in a manner consistent with the customer interest

87. The Union proposes that employers and licencees should identify an expectation that, for a defined portion of clients, the appropriate advice should be to do nothing at all. Advisers, licensees or regulators should be able to identify, based on broad assumptions, a percentage of customers for whom the correct advice will be to do nothing. Advisers and licensees could be required to identify the reasons for significant departure from such a percentage.

88. The Union generally submits that should incentives remain, they should focus on the following.

(a) employee promotion not based on sales but on ethical conduct and customer outcomes;

(b) the introduction of incentives based on customer retention; and

(c) the introduction of incentives based on an assessment of quality advice and customer outcomes.

F-9 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?[26]

89. The Union's extended experience is that compliance issues, whether identified through routine compliance measures or not, are escalated in a selective manner that fails to assist in addressing systemic issues, and undermines confidence from an adviser and employee perspective as to the integrity of the compliance process.

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[26] T1959.27.

90. Put simply and colloquially (and consistent with the evidence in connection with Mr. Smith), there is a general sense that compliance doesn't matter so long as the adviser is making money. Similarly, in the Union's experience, in the event advisers cease to make money compliance audits are one of the levers used to exit them.

91. The Union submits that the best mechanisms to encourage compliance are:

    (a) A baseline ethical framework that is consistent with a compliant culture;

    (b) Maintenance of systems that are consistent with compliance. By way of example, we refer to the case study involving NAB planners and witnessing of death beneficiary nomination forms. In that case study, the planners were sent, alone, to see clients in their homes. While again not excusing behavior, the system of work established by NAB created an obvious difficulty for the witnessing the forms correctly;

    (c) That disciplinary action, when taken, is fair on the question of systemic v. individual responsibility, and is consistent and proportionate to the compliance issue; and

    (d) That the manner in which compliance is addressed is completely unrelated to the sales performance of the adviser.

92. Further, and in some ways most significantly, it is important that licencees maintain systems that encourage self-reporting. Such a system goes beyond formalised whistleblower protection.

93. The Union's experience is that workers may identify and report a longstanding compliance breach following, for example, undertaking a training session. The report will often be in the form of the adviser or employee saying words to the effect of - *"I just realised that the way we have been doing this for years is nto compliant".*

94. The Union's experience is that the employers tend to then take disciplinary action against the employee (and potentially also call out other employees who were likely engaged in the same compliance failure). Such an approach has an enormously chilling effect on the willingness of employees to report identified compliance issues.

95. The issue also raises a question as to why employers conduct training as opposed to simply focusing on audits. The normal understanding of training is that it will improve the ongoing performance of staff, not act as a trigger for disciplinary action.

G Inappropriate financial advice - ANZ, RI Advice Group Pty Ltd and Millennium 3 Financial Services Pty Ltd

G-10 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?[27]

96. It is clearly possible for licensees to adequately monitor the quality of the advice provided. Further, to the extent, a licensee believes that it is unable to do so, the issue that should be addressed is the structure and model of engagement being employed by the licensee.

97. The fact that the advice is provided in a "manual environment" is not relevant to whether there can be adequate monitoring of quality. Prior to the last 25 years. all kinds of professional advice were provided only in manual environments.

98. The answer to adequate monitoring does not lie in technological improvements or algorithms. Had this question been "*Is it possible for financial services licensees to use technology to adequately monitor the quality of advice provided by employees and authorised representatives*" the answer would have been no. The intricacies of high-quality financial advice involve an assessment of numerous factors that cannot be replicated by computer coding.

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[27] T1969.26.

99. Rather than seeking solutions through technological checks, the licensees should focus should on:

    (a) compliance monitoring systems that contain a significant focus on ongoing training;

    (b) improving culture and work practices;

    (c) the professionalisation of financial advice and the development of a stronger ethical framework embraced and enforced by advisers, senior management, and the licensees;

    (d) continuing education and training of licensees.

100. The Union believes that there has been a reduction in the value placed on human compliance and training in all parts of the sector. This has included, specifically, a reduction in compliance officers in branches, and, in the context of financial advisers, the removal of support in the form of paraplanners.

G-11 Are improvements in technology the only way to ensure that financial advisers provide quality advice?[28]

101. Not only are improvements in technology, not the *only* way to ensure that financial advisers provide quality advice, they are not even *a* way to ensure that financial advisers provide quality advice.

102. The Union repeats its submission in relation to Question G-10 (paragraphs 96-100 above).

103. To the extent that there is a premise underlying the question that, left to their own devices, planners will not provide quality advice, the premise should not be accepted.

104. Technological solutions will ultimately lead to a binary, rules-based approach. Such an approach is anathema to quality advice. Rather, the appropriate changes to ensure that financial advisers provide quality advice include:

    (a) steps to promote financial advice as a profession, with improved and ongoing education requirements;

    (b) remuneration and reward models that are not based on revenue, product sales, commissions; and

    (c) licensees and employers promoting and maintaining a culture that values ethical conduct and the long-term interest of the client over revenue and profit.

105. Technological solutions also lead to an increased risk of boiler plate advice, and reliance on systems and precedents that do not fully assess the needs of the customer. Without suggesting that technology was the cause of the issue, the type of advice issued to Ms McKenna (with the enormous associated risk) is an example of what is likely to happen with over reliance on technological systems.

106. Over the last 15 years, financial institutions have attempted to replace employees with computer processes. In both this round, and the first round of case studies there have been several large failures that arose as a result of over-reliance on technological solutions. While technological solutions may assist in the provision of quality advice, a process of assessing the customer's need, identifying the customer's goals and, with the customer's trust recommending products requires an educated and trained human.

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[28] T1969.30.

G-12 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?[29]

107. The Union has limited insight on this matter.

108. The Union submits that the more proximate the relationship between licencee and adviser, the better able the licencee is to protect the customer.

109. The Union notes that such a process may involve a balancing of the interest of the consumer, and of the financial adviser and that care should be taken to ensure that no process is endorsed that would unfairly or disproportionately impact on the adviser prior to any decision being made.

110. Such balance would, of course, need to be dealt with by reference to the nature of the complaint, the ongoing risk, the prima facie evidence, and the adverse effect on the adviser of any decision that would impact their remuneration or reputation.

G-13 Taking into account that it may never be possible to reduce the risk to zero, what is an acceptable level of risk that customers will be provided with inappropriate advice?[30]

111. The Union has limited insight on this matter and does not believe it can assist the Commission.

H Inappropriate financial advice - AMP, AMP Financial Planning Pty Ltd, Charter Financial Planning Ltd and Genesys Wealth Advisers Ltd

H-14 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?[31]

112. Clients should be advised as soon as practicable.

113. Such advice should contain a reference to opportunities for remediation and should not unfairly attribute responsibility for any error onto the individual adviser or employee.

114. Such advice should not be delayed by concerns within the licensee of triggering significant breach reporting obligations. Similarly, such advice should not be used as a tool to attribute (or misattribute) responsibility. The licensee has significant power to undermine the relationship between the customer and adviser, and that power should not be an inappropriately utilised or abused.

H-15 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[32]

115. The Union relies upon without repeating its submission at paragraph 112 above. Clients should be advised of their rights in connection with remediation as early as practicable and should be kept informed as to the progress of any remediation. The time is taken for remediation by the AMP, for example, was manifestly excessive.

116. The Union further submits that processes for remediation (including the timing of remediation) should be part of a comprehensive Financial Services Code.

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[29] T1969.31.
[30] T1969.34.
[31] T1976.30.
[32] T1976.33.

I Improper conduct by financial advisers

I-16 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?[33]

117. The short and simple answer to this question is *by ensuring that the financial services licensees maintain and promote a just and ethical culture.*

118. The Union submits that, in the context of employee conduct, a just and ethical culture means:

(a) a culture where ethical conduct is promoted over sales and revenue;

(b) that employees are provided adequate and appropriate training, and are not held to account in circumstances where their behaviour was consistent with their training;

(c) that where allegations are made against employees, they are provided procedural fairness in connection with the allegations;

(d) that where the poor behaviour arises (in whole or part) because of systemic or cultural failures, the financial services licensee acknowledges its contribution to the poor behaviour as a result of that systemic failure;

(e) that disciplinary action or other penalties imposed on employees is consistent, and is fairly imposed upon management and executives who were responsible for systemic failure; and

(f) that disciplinary action or other penalties imposed on employees is proportional to their actions, taking into account the extent to which their actions arose because of systemic failures.

119. The Union also relies upon without repeating its response to Question F-9 above (paragraphs 89-94).

120. This question posed by the Royal Commission arises in part from a case study around the conduct of financial planners at NAB, in connection with a practice around the witnessing of death beneficiary nomination forms. The forms required two witnesses (neither being the proposed beneficiary). Planners who attended the homes of the client developed a practice of witnessing the forms themselves, in the presence of the client, and then having a colleague (who had not witnessed the client's signature) sign as the second witness.

121. The practice should have been either to identify a second witness at the time or to leave the form with the customer for them to sign later when they had two witnesses present.

122. The Union was involved in this matter on behalf of the financial planners. It did not assert that the planners had not made an error but sought to have the matter addressed in a manner consistent with the principles set out above.

123. From the evidence before the Commission it was clear:

(a) That the practice was so widespread as to clearly be a systemic issue.

(b) That the practice created a small risk of the forms being invalid, which would, in turn, have very significant consequences for the customer.

(c) That there was no benefit to the staff member from the practice. It seems clear that the practice developed to reduce the inconvenience on the client and minimise the risk that customer would fail to send the form at a later date if it was left with the client.

(d) That NAB was aware that the issue was a systemic one and, within management, addressed the issue on that basis.

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[33] T1979.45.

124. The Union submits that the issue is a clear example of a cultural failure. It is not fair to suggest that the advisers were acting unethically: such a concept would require that there be some corresponding benefit to them. That was not the case. Rather, collectively they failed to understand the importance of compliance with the terms of the form, and they prioritised the short-term convenience of the customer over the customer's long-term protection.

125. Employees involved were subjected to two forms of disciplinary action. The first was an amber gate (which was non-reversible for planners, and reversible for administrative staff). The second was that they were advised that, should they seek alternate employment and there be a request pursuant to the Conduct Background Check, the potential future employer would be advised:

> *In 2017, the Adviser self-reported to NAB that they may have been involved in the improper witnessing of one or more non-lapsing beneficiary nomination forms. The Adviser was informed about the correct process. Where appropriate, internal consequence management was applied. NAB did not identify any apparent intent to deceive or to gain a personal advantage. It was apparent that the practice was undertaken to save the client inconvenience and delay, and the Adviser may not have understood the implications of improper witnessing. Notwithstanding, the conduct was improper and may have potentially invalidated the beneficiary nomination form.*[34]

126. The Union submits that the way NAB dealt with the matter failed to meet the principles outlined above in several important respects. Specifically:

(a) there was no acknowledgment to staff that NAB had contributed to the issue through systemic and cultural failure. To the contrary, the answer to the CBC reference question clearly excluded any inference that the issue was widespread, or systemic in nature, but rather attributed sole responsibility to the employee.

(b) the action taken was not fair as between the planners and the management and executives responsible for the systemic failure. The Union notes that Mr. Hagger and Mr Steele, the two executives responsible both had reductions of less than 10% of their STI payments, while the advisers had their STI reduced by 25%.

(c) The action taken was not proportionate to the behaviour. The Union submits that the decision by NAB to inform any potential future employer, in the terms proposed, created a very significant barrier for the employee to obtain alternate employment. This action was disproportionate to the conduct, given the systemic and cultural nature of the issue.

127. The NAB advisers revealed and admitted the behaviour. NAB missed an opportunity to deal with a systemic behaviour through appropriate training and to acknowledge the frankness of the advisers' admissions. The disciplinary action instead created a disincentive for employees to be so frank in the future.

I-17 How should financial services licensees recognise and reward ethical conduct by financial advisers?[35]

128. The Union refers to its submission at Part B in connection with culture.

129. Ethical conduct should not be viewed as an add-on to be rewarded. Ethical conduct should be a central feature of culture, and of the operation of each financial services licensee, each senior manager within such an organisation, as well as employees and representatives including financial advisers.

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[34] The Union acknowledges that this information (including the email text) is not in evidence before the Commission.

[35] T1980.01.

I-18 Are there particular characteristics of the financial advice industry that 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?[36]

130. The answer to the question is no.

131. There are more than 25,000 financial advisers working in Australia, as part of about 500,000 workers engaged in the financial services sector. The vast and overwhelming majority of those workers are honest and ethical individuals who strive daily to assist their customers to the best of their capacity.

132. The Union has noted an increase in hostility to workers in the sector as a result of the Royal Commission. We respectfully suggest that the Commission be careful not to impugn the integrity and character of the many, as a result of cultural and systemic failures of the institutions, and the conduct of the few.

133. There is nothing inherent in the financial advice industry that means that there is a higher incidence of improper, unethical or dishonest conduct. The Union notes that there is no evidence before the Commission (or so far as we are aware, in existence) that would support the proposition that the rate of problematic conduct is higher in this industry than in law, accounting, or any other industry.

134. There are characteristics of the financial advice industry that make the consequences of improper, unethical or dishonest conduct particularly devastating. Those characteristics include that it deals with the life savings of individuals, often around retirement age when the individuals are particularly vulnerable and are not able to financially recover.

135. The potentially significant consequences and the special vulnerability of many of the customers justifies a focus on ensuring that measures to avoid and deal with improper, unethical and dishonest conduct are warranted. The Union submits that the appropriate responses lie in a focus on cultural reform and better regulation.

J The disciplinary regime for the financial advice profession

J-19 Are the steps required by the ABA reference checking and information sharing protocol adequate to protect the public when financial advisers transfer between licensees?[37]

136. The ABA reference checking protocol is inadequate and inappropriate. The Union submits that in its current form it is unfair and will lead to litigation.

137. The protocol currently provides no useful protection to the public. Its primary function is to protect the institutions which are signatories by each signatory alerting other signatories about asserted risks attendant on the employment or appointment of an individual. While such an alert may assist another institution, it does nothing to prevent the appointment of the individual to a position with a non-signatory (or indeed to a signatory who wished to engage the individual notwithstanding the protocol such as it seems likely Dover would have done). There is no process (and given the complete absence of procedural fairness there should be no process) whereby the protocol alert is provided to the public.

138. The second function of the protocol is to protect the commercial reputations of the signatories. The protocol reduces the possibility of prosecution or public disclosure of any issues that arise and in so doing, reduces the possibility of each institution suffering reputational damage as a result of being publicly associated with an adverse event.

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[36] T1980.02.

[37] T1984.44.

139. The Commission should not endorse the ABA protocol in any way. The ABA protocol is a private organisation system created to fill a gap in the regulatory regime.

140. The Commission should instead endorse a process for disciplinary action and consumer protection that is overseen by a statutory authority (be it ASIC or some other entity). The Union repeats its submissions at Part C above.

141. The Union submits that there are many reasons the ABA reference checking protocol should be rejected.

142. The first and most obvious is that any regulatory system should be comprehensive. The ABA protocol operates based on a subscription model. As was evident from the practices of Dover as indicated by the evidence before the Commission, a lack of universal application simply means that inappropriate advisers will move to licensees that do not subscribe. Indeed, given the evidence of Mr McMaster as to the importance of issues that would be raised in a ABA check, even if Dover had been a subscriber, it seems likely that they still would have engaged the advisers.

143. Second, the ABA protocol is fundamentally unfair. It obliges an organisation to provide to potential future employers information adverse to an individual in circumstances where the individual has no capacity or right to ensure that the information is correct. The Union identifies this as a form of disciplinary action taken against employees. It places the financial adviser in the position of weakness against their employer/licensee where their capacity to obtain employment with another licensee is significantly impacted.

144. Third, because the effective punishment under the ABA protocol is so blunt – the naming of individuals to potential future employers for a period of five years – it will involve punishments that are disproportionate to the allegations made.

145. Fourth, while the ABA protocol is expressed to be limited to conduct issues, the line between conduct and performance is often difficult to identify. Matters such as maintaining file notes, meeting response time expectations and the like are often expressed as conduct when they are better understood as performance matters,

146. Fifth, meaningful consumer protection can only be achieved by banning advisers who are the subject of significant adverse findings, or publication of those adverse findings in a manner accessible to the public. The ABA protocol achieves neither of these things.

147. Sixth, it is open to being gamed. The Union has already had experience with employers inviting employees to resign prior to the commencement of an investigation so as to avoid the triggering provisions of the protocol. Such an outcome, which will occur most commonly in the most egregious cases, subverts the intent of the protocol entirely.

J-20 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?[38]

148. The Union refers to its submission at Part C in connection with regulation.

149. The Union submits that financial advisers should be subjected to a licensing regime that would require them to meet minimum education and ethical standards. Such a regime should be part of a more general code that imposes ongoing obligations on licensees, and on senior officers within licensees. Such a code would, by its operation, require that licensees maintain an appropriate level of satisfaction with an authorised representative at the time of their appointment, and always thereafter.

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[38] T1984.46.

150. Within this context, the Union submits that it is appropriate for licensees, on the appointment of authorised representatives, to take measures to ensure that the representatives will act in a manner consistent with the cultural expectations of the licensee.

151. The Union refers to the evidence of Mr Haggar which revealed the greater difficulty licensees had enforcing standards and conduct of authorised representatives when contrasted with the employees.

J-21 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? [39]

152. The Union refers to its submission at Part C in connection with regulation.

153. The Union submits that obligations of the kind contained in s.912A should be incorporated within a Banking Code. Such a code should provide for accountability to all entities, and at many levels including:

(a) at an entity level – there should be enforceable accountability obligations on licensees, product issuers, platform providers and employers of financial advisers; and

(b) within an entity there should be enforceable accountability obligations on senior management.

J-22 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? [40]

154. The Union submits that the current division of responsibility is not operating effectively.

155. The entities identified in the question as involved in the question of responsibility are not comprehensive. For Authorised Representatives, the relevant AFSL also has significant obligations to maintain professional standards. Similarly, where the AFSL is a subsidiary of a larger financial institution, that institution has obligations in connection with the standard of advice issued by advisers.

156. The current system:

(a) does not properly assess or address the risk a financial adviser may pose to consumers;

(b) is vulnerable to acts of self-interest by employers and AFSL holders who may wish to avoid consumers becoming aware of issues. We note concerns of this kind in a number of the case studies;

(c) is vulnerable to participants withdrawing from subscription services, such as the ABA protocol or the FPA; and

(d) is near incomprehensible.

157. The limitations and failures of the current regime that permit such disciplinary processes to be undertaken were clearly revealed in the evidence of Ms. McKenna, as well as the evidence of Mr. Henderson, and the officers of the two Professional Associations. The Commission and public would have no confidence that the FPA or the ALA is able to operate appropriate disciplinary processes. The Union identifies the following issues that arose from the case study (and the associated evidence):

(a) None of the potential regulatory entities, or avenues for appeal, understood that it was their job to assess whether Mr Henderson's conduct in connection with Ms McKenna

[39] T1985.43.
[40] T1985.46.

meant that he posed a risk to others. The central feature of Ms McKenna's concern was that if she, with a high level of education and awareness had only narrowly avoided terrible advice, there was a real risk that others would not be so lucky. None of the interested entities took any interest in this element of the matter.

(b) The tolerance for communication from Mr. Henderson to senior offers of the organisation clearly intended to influence the investigation was extraordinary.

(c) The focus on summary disposal and agreed outcomes were inappropriate.

(d) The records of the number of disciplinary investigations and their outcomes provided no comfort or confidence of capacity.

(e) The FPA acknowledged that it had limited power to cause behaviours to change and that the only significant weapon in its arsenal was disclosure of the adviser's name. Given this, it was clear that the FPA seldom deployed this weapon.

(f) There was a contest between Mr. Henderson and Mr. Dante as to whether the FPA process could continue to apply after Mr. Henderson's resignation from the FPA, other than by a voluntary act of Mr. Henderson. Mr. Dante's assertion that it could seems contrary to the voluntary nature of the membership of the organisation.

(g) The process took over twelve months to complete and remains unfinished.

158. The Union acknowledges that there is a need for employment issues, professional disciplinary issues, and potential unlawful conduct to be addressed by different entities, and in different ways. However, the current regimes fail to identify the ambit of each of these segments, and then, in turn, fails to ensure that each segment is properly addressed.

159. Issues should be initially addressed by the employer. In the event they deal with employment matters alone and do not involve a failure of ethical obligations, that should be dealt with internally without reference to any external entity.

160. In such circumstances, it is inappropriate for employers to jointly create a system where there is an obligation on the employers to comment adversely about employees who are disciplined, terminated (or who resign subject to investigation), and have that fact communicated to other external parties. Such internal processes should be fair, transparent and appropriately allocate responsibility between systemic and individual issues.

161. Conventions in relation to the provision of references by a former employer to a new employer are the subject of well-established norms. It may be that the appropriate response for a former employer is to elect to say nothing, as a matter of policy. Other processes, such as the provision of a statement of service, or agreement of an identified contact person are also appropriate. The imposition of contractually mandated warnings about an employee, such as is provided for by the ABA protocol, in circumstances with no independent finding as to the employee's conduct, is not appropriate.

162. In the event the issue involves a failure of ethical or professional obligations it should be addressed by an independent entity (not a voluntary association) which has jurisdiction to deal with all such matters without the need for membership or subscription. The employer or such disciplinary body should also have the capacity to refer the matter to a regulator, like ASIC, for prosecution.

163. Such disciplinary procedures and prosecutions should be done in a manner that affords the adviser procedural fairness and ensures that any penalty is proportionate to the wrongdoing.

J-23 Does that division of responsibility create gaps in the disciplinary system? If so, what are they?[41]

164. The Union repeats its submission in relation to question J-22. The division of responsibility creates significant and unacceptable gaps.

J-24 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?[42]

165. The Union submits that it is both possible, and desirable to:

(a) implement a single system for professional discipline of financial advisers; and

(b) introduce a system of licensing at both an individual and an entity level.

166. The Union submits such changes should also include measures to provide, for senior management, responsibility and accountability for the conduct of the licensee.

167. The Union refers to is submissions in connection with regulation at Part C, and in answer to J-23 above.

J-25 Is there a 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?[43]

168. The Union submits that there are significant deficiencies in the regulatory culture that has developed in connection with the financial advice industry. The Union identifies the following:

(a) A focus on the conduct of the individual advisers (and to a lesser extent the licensees) rather than the conduct of the other relevant parties and entities such as the product manufacturers and platform providers.

(b) A failure to properly regulate the conduct of the top level entities that have the power to determine culture, incentives and remuneration models and should be held to account for the logical and predictable consequences of their conduct.

(c) An absence of regulation that holds senior managers of licensees and other significant entities accountable for their conduct.

(d) A regulatory system that is overseen by multiple statutory entities which leave gaps in responsibility

(e) A prime regulator, ASIC, that has been under-resourced for this work and has, as a result, taken a risk-averse strategy of negotiation and “enforceable undertakings” rather than exposing the institutions to the significant reputational risk of genuine prosecution.

(f) An absence of disciplinary processes (noting that ASIC does not see itself as engaged on this issue) which has, in turn, led to the creation of a series of inadequate half-measures such as the FPA disciplinary process and the ABA protocol.

J-26 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?[44]

169. The Union repeats its response to question J-25.

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41 T1986.04.
42 T1986.05.
43 T1986.11.
44 T1986.13.

K Approved product lists, conflicted remuneration, and white label products.

K-27 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?[45]

170. The Union respectfully submits:

(a) the question identifies that vertical integration creates an inherent risk of conflicts;

(b) the question omits to identify that the impact of the conflicts inherent in vertical integration is not limited to financial advisers, but potentially impacts the behaviour of incentivised managers, and the behaviour and expectations of executives and financial institutions; and

(c) the answer is that such conflicts can be managed by financial advisers if they are appropriately trained and supported, there is a good culture in place, and the financial institution has identified, and addressed the potential issues created by vertical integration. Further, such measures need to be taken to address the conflicts created by vertical integration as they operate in other parts of the institution's business, and also as they operate on other actors such as managers, within the financial advice businesses.

171. The Union submits that the Commission should not conclude that vertical integration, *per se*, is bad. It is not. In the context of financial advice, it creates a series of potential benefits for consumers including, most obviously the efficiency and safety of having a financial advice relationship with only one entity or institution.

172. A model which enforced separation of products and advice would likely cause the large institutions to withdraw from the provision of advice, and instead force financial advisers to work as sole practitioners, or in smaller dealer groups. This alternate proposition, which would mean that financial advisers would operate in a manner very similar to mortgage brokers, would create a different, but equally or more serious, set of risks and regulatory challenges.

173. Further, such a model would not necessarily eliminate conflicts of this kind. It would remain in the product manufacturers interest to incentivise.

174. For example, issues around the use of Approved Product Lists (APLs) should be understood as linked to, but also distinct from, vertical integration. The Union acknowledges APLs are an appropriate mechanism for licensees to minimise consumer risk. In the event of a forced separation of products and advice it is very likely that most licensees that provided advice would continue to maintain APLs.

175. In order to address the issues raised by the conflicts, the nature of each of the potential conflicts should be identified. The Union identifies the primary conflict is that the licensee, that profits from investment in its products, is incentivised to recruit customers seeking advice to its products. This primary conflict, in turn, creates a possibility/likelihood that the licensee will incentivise its employees, managers, and representatives to do this, in turn placing them in a position of conflict. Such incentives include:

(a) The creation of targets around investments in products manufactured by the licensee;

(b) Rewarding investments in products manufactured by the licensee;

(c) Using internal networks to promote or advertise products to financial advisers;

(d) Creating disincentives for investment in products manufactured by others, such as by use of APLs.

176. The Union notes that none of these conflicts are created by the financial adviser but are each a function of the conduct of the licensee as a product manufacturer. The primary responsibility in

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[45] T1986.23.

connection with each of these conflicts does not rest with the financial adviser. To the extent this primary conflict operates on their behaviour, it is because of a decision made by the licensee/product manufacturer.

177. This conflict can be relatively easily managed in terms of financial advisers by removing any incentive (be that addressed in a positive bonus or negative target) from the financial adviser.

178. The conflict is more difficult to address in connection with managers and executives who have responsibility for product manufacture and influence over the conduct of advisers. The most obvious example of this is at the executive level where a person's remuneration will be increased by reference profits generated in products manufactured by the licensee, and that same person has the capacity to influence the expectations placed on, and the incentives provided to, financial advisers and their supervisors.

179. The Union further acknowledges that a secondary, more subtle conflict also exists and may impact the conduct of financial advisers and others. This conflict arises as result of emotional and behavioural bias many financial advisers will have to recommend products manufactured by their licensee.

180. There is a natural tendency for employees or representatives of an organisation to believe, genuinely, that the products of that organisation are better than those of a rival. Similarly, a financial adviser from Company A who recommends products manufactured by Company B as being more appropriate for the customer may be concerned that the customer will also conclude that the financial advisers at Company B should also be preferred.

181. This bias is also evident in APLs. It is clear that the conflict can be managed, in part, by ensuring that there are competing products manufactured by others, in all parts of an APL. However, the bias towards the licensee's products will remain as it is unlikely that any of their products would be omitted from an APL.

182. Indeed, the assumed scrutiny that the licensee undertook in connection with their product is one of the attractive features of vertical integration to the consumer.

Separation of products and advice

183. The Union submits that the separation of products and advice would be of relatively limited benefit in addressing the issues created by vertical integration.

184. The Union notes the recent announcements made by NAB, CBA, and ANZ expressing an intention to reduce their involvement in the provision of financial advice. The preliminary indication seems to be that these institutions are creating a degree of separation.

185. However, the Union respectfully submits that the Commission should not understand that this will eliminate, or even significantly reduce the conflict issues. Similarly, the Union does not believe, absent other regulation, that separation would of itself eliminate, or even significantly reduce the conflict issues.

186. The Union makes the following observations in support of this submission.

187. Firstly, the decision to exit financial advice does not mean that the institutions will cease to offer general advice. One of the additional consequences of the FOFA reforms was an emphasis by the large banks on branch workers and contact centre workers doing more to sell financial services products. Such sales are almost exclusively of vertically integrated products.

188. The provision of general advice by branch workers is, in many ways more problematic than the provision by financial advisers. As was described in the Union's submissions to the first round of case studies:

(a) products promoted by way of general advice commonly includes superannuation and insurance products;

(b) such products are included in targets that employees must meet for performance reviews; and

(c) such products are counted towards revenue goals that in turn lead to STI payments to employees and managers.

189. Further, the absence of FOFA regulation on the provision of general advice has created an incentive for institutions to encourage general advice (which is done by individuals without the specific training and expertise) instead of being done by financial advisers with the expertise and training.

190. Secondly, the comments of NAB in connection with the announced sale of its MLC business are illuminating. In its announcement, NAB indicated that:

> *"It is expected that there will be ongoing arrangements between NAB and MLC, to offer NAB customers continued access to advice and products to meet their wealth management needs"*[46]

191. It seems likely that there will remain a contractual relationship between NAB and a divested MLC that will involve the advisers remaining incentivised (to greater or lesser degrees) to sell NAB products. This sort of separation provides no significant additional layer of protection to consumers.

K-28 Should the statutory carve-outs to the ban on remuneration, including the recent carve-out in relation to insurance commissions, be maintained. If so why?[47]

192. The Union repeats its submission in connection with Question D-3 above. The Union supports the FOFA reforms and supports, generally, a fee for service model over a commission model. The Union does not support the maintenance of any carve-outs, be they in connection with superannuation and insurance, or in connection with general advice as opposed to financial advice.

193. The Union submits that in the event there is a further move away from commissions, there must be a corresponding adjustment to remuneration of employed financial advisers. It is neither fair nor appropriate for advisers to bear the adverse effects of any such change. To this end, a focus in fee for service based on hourly rates should be endorsed.

[46] NAB 2018 half yearly results summary announcement to ASX (https://www.nab.com.au/content/dam/nabrwd/About-Us/shareholder-centre/documents/2018-half-year-results-asx-announcement.pdf).

[47] T1986.25.