Westpac Banking Corporation – General Submissions on Financial Advice

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

7 May 2018

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General Submissions of Westpac Banking Corporation

1. These submissions address the general questions in respect of which Counsel Assisting invited all parties to the Financial Advice Hearing of the Royal Commission, to make submissions.[1]

2. These submissions complement and may cross-refer to submissions Westpac filed on 4 May 2018, regarding the Smith and Mahadevan Case Studies.[2]

Question 1: Do clients receive any meaningful benefit from ongoing service arrangements? T1948.11-12

3. An ongoing advice arrangement with a financial adviser can provide significant benefits to clients. Putting a financial plan in place to advise in relation to superannuation, insurance and investments is an important step in building and protecting wealth and providing for retirement. Reviewing and updating that plan over time is equally important as individuals are approaching retirement to ensure that their assets are protected and that their strategy remains appropriate. The ongoing relationship has three parts. Firstly, it provides a forum for a periodic review with a financial adviser to help confirm that clients' financial plans and strategies remain consistent with their goals, needs and aspirations as these change over time and that the advice is being appropriately monitored, executed and adapted if necessary. In addition, the ongoing relationship also enables clients and advisers to consider and respond to changing circumstances and seeks to check that the investments made are consistent with a client's risk appetite and profile. For example, as part of the ongoing relationship, financial advisers will contact clients when research and market outcomes necessitate a change or reconsideration of the client's investments.

4. Secondly, it also allows changes in law, regulation and markets, including the availability and price of financial products, to be considered and the strategy modified to take these into account. For example, changes in superannuation law may change clients' investment strategies and approaches to retirement. Since 2016, there have been more than 20 changes to superannuation and related laws which have had the potential to significantly impact clients' retirement planning strategies. The complexity of the financial advice landscape and its constantly evolving nature means that there can be real value in clients forming a longstanding relationship with their adviser.

5. Thirdly, an ongoing advice arrangement also helps establish a longer term understanding of the client's circumstances and a relationship of trust between the adviser and the client.

6. The services offered by BT Financial Advice (**BTFA**) demonstrate the types of benefits available to clients. BTFA offers a variety of ongoing advice packages to clients to meet different needs. Generally, in addition to the business as usual services associated with liaising with clients, reporting and general administration, these packages include four key services:

[1] T1936.26-29, T1948.9-16, T1953.26-32, T1959.18-25, T1969.24-36, T1976.29-37, T1979.44 – T1980.5, T1984.43 – T1985.2, T1985.42 – T1986.2, T1986.20-27.
[2] T1959.18-32.

a. a periodic review (usually annually or six monthly) where the financial adviser discusses with the client their needs and aspirations, reviews investment performance, asset allocation and risk, discusses new developments and together takes any agreed action to keep the client's plan on track;

b. liaising with clients' advisers (including taxation, accounting and solicitors);

c. ongoing access to a financial adviser to answer questions or provide assistance, including gathering additional experts to respond, for example to changes to the client's circumstances or manage insurance claims; and

d. regular communications updating the client on relevant issues, such as legislative changes.

7. All BTFA clients are provided with an annual fee disclosure statement and must choose at least every two years to 'opt in' to the arrangement or it will be cancelled.[3] Additionally, clients can 'opt out' of ongoing advice arrangements at any time. This means that if a client ceases to see any value in the arrangement, it will be ended.

8. BTFA has a number of controls in place to ensure that services are being delivered where ongoing advice fees are being charged including regular monthly monitoring to ascertain whether periodic reviews are being provided to ongoing advice clients.[4]

9. Westpac also supports the provision of additional guidance on ASIC's MoneySmart website to assist clients to assess the value of ongoing advice. This additional information could include guidance about the typical level of ongoing advice fees as well as the range of different services offered as part of ongoing advice service packages offered in the market.

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? T1948.12-16

Question 3: Should grandfathered commissions cease? T1948.16

10. It is convenient to address Questions 2 and 3 together.

11. Westpac supported the introduction of the Future of Financial Advice (**FoFA**) reforms and recognises they have played an important part in improving client outcomes in the financial planning industry.

12. Since the implementation of the FoFA reforms, advisers have been prohibited from earning conflicted remuneration (as defined) in respect of new clients. In relation to existing clients, there has also been a gradual transition from arrangements which permit the payment of commission-style fees to

[3] Ex 2.101 First Wright Statement, [81(c)] and [136]. The policy of BTFA is to apply the fee disclosure and 'opt in' requirements to all customers including pre-1 July 2013 customers, and BTFA chooses not to rely on the grandfathering exception available under the FoFA legislation for pre-1 July 2013 customers.
[4] Many advisers within the BT Group Licensees (**BTGL**) network do ensure that customers 'opt in' at least every 2 years, but the current policy does not require this for pre 1 July 2013 customers (as this is not required by the FoFA legislation).

advisers being remunerated on the basis of the advice that they provide (i.e. regardless of the identity or volume of the product).

13. As a result of the grandfathering, a range of pre-FoFA arrangements remain in place which are subject to formal systems and processes to reduce the possibility of any perceived conflict affecting the advice provided.

14. Westpac is not aware of any connection between the retention of 'grandfathered' commissions and 'fee for no service' conduct occurring. However, Westpac is supportive of any industry wide steps to accelerate the move away from grandfathered commissions and any perception of ongoing conflicts associated with commission based structures, provided any move in that direction has appropriate regard to:

    a. the impact it would have on clients' access to advice due to increased costs; and

    b. the viability of advisers and adviser businesses which are currently affected by those revenue streams.

15. Irrespective of whether the Commission recommends changes to grandfathering, Westpac submits that it could consider recommending Capital Gains Tax rollover relief to remove any adverse tax implications for clients who would otherwise benefit from moving out of a grandfathered arrangement and into a post-FoFA arrangement. Comparable relief may also be required where, for some clients, moving out of a grandfathered arrangement and into a post-FoFA arrangement may result in them losing access to social security benefits (relevant to account based pensions commenced prior to 1 January 2015).

16. Many financial advisers and financial advice businesses that are small businesses remain, to varying degrees, dependent on grandfathered arrangements.

17. A product provider unilaterally moving quickly away from the payment of currently permitted remuneration could be at a material disadvantage compared to a product provider that did not. Similarly, a financial advice business that sought unilaterally to move to a wholly client-paid fee for advice model could be at a disadvantage to a financial advice business that was able to continue to offset clients' apparent advice-related expenses as a result of the receipt of these payments.

18. Given the potential impacts on financial advice businesses and clients which remain similar to those which informed the original grandfathering of the provisions and which are identified above, Westpac believes that legislative or regulatory intervention will be required to support this change happening on a consistent and coordinated basis, in a way that assesses and manages broader implications for the industry to minimise unintended consequences.

PLATFORMS - GENERAL

Question 4: Does vertical integration of platform operators with advice licensees serve the interest of clients? If so, how? T1953.27-29

19. Vertical integration of platform operators with advice licensees can operate in clients' interests in a number of ways provided appropriate protections are maintained. In considering that issue, it is useful to again consider the nature of platforms which, while defined as a 'financial product', for the purposes of the *Corporations Act 2001* (Cth) (**Corporations Act**), are predominantly an administrative tool to assist in the management of investments. Platform operators provide custodial arrangements for financial products to clients. Platforms are information technology systems which provide the means for clients and their financial advisers to:

    a. give instructions and directions to the platform operator about acquiring or selling financial products on behalf of the client;

    b. monitor an investment portfolio in one place; and

    c. generate consolidated reports across the portfolio to assist with reporting and meeting taxation and regulatory requirements.[5]

20. Platforms can be used to hold both portfolios managed directly by investors (known as an investor directed portfolio service (**IDPS**))[6] and portfolios related to superannuation (in both the accumulation and retirement phase) through regulated superannuation funds related to the platform.[7] Platforms can be owned and operated by a standalone entity, or through an entity that also owns and manages an advice business (**Integrated Businesses**). In either of these situations, potential or perceived conflicts can arise (for example, a perceived conflict could arise through an exclusive distribution agreement as well as through an ownership structure) and must be managed appropriately.

21. Platforms offer a range of benefits and potential benefits to clients and their advisers, including:

    a. offering an extensive menu of investment options and the ability to buy and sell those options through an online portal;

    b. access to investment options that they may not be able to access directly, such as access to wholesale investments at a lower cost when compared to retail funds, through the platform operator using its scale to negotiate lower fees with the product manufacturers;

    c. netting of transactions or the pooling of funds leading to costs savings;

    d. access to consolidated reporting and preparation of annual tax statements;

    e. tools to assist in investment decisions including analysing asset allocation across the portfolio;

[5] Ex 2.11 Statement of Constandina Kotsopoulos, [7].
[6] These are governed by ASIC Class Order 13/763.
[7] Ex 2.11 Statement of Constandina Kotsopoulos, [10].

f. for superannuation platforms, an outcome similar to a Self Managed Super Fund (**SMSF**) without the compliance and regulatory costs and burden of managing a SMSF; and

g. making their advisers more efficient, by simplifying trading and reporting.

22. BT Financial Group's (**BTFG**) platforms are not restricted to clients who obtain financial advice through BTFA or BTGL. Many of the rival platform operators sit within broader financial services groups (such as AMP, Commonwealth Bank, Macquarie, ANZ and Perpetual) but others (such as NetWealth) do not.

23. Provided there are appropriate controls, there are material benefits for clients of Integrated Businesses. In particular:

a. Integrated Businesses may allow clients to view their investment and superannuation alongside their online banking, allowing for reporting all in the one place. The integrated platform permits enhanced reporting functions including taxation information;

b. the integration of the advice and platform businesses facilitates a more holistic view and approach to the provision of advice and helps ensure that the platform(s) are designed and operated in a way that best facilitates the needs and requirements of advisers and their clients. It also helps to make sure the platform will be used in the manner intended;

c. clients of an Integrated Business have the benefit of receiving all of the administration and execution aspects of their investments from the one entity which streamlines management and enables clients to have a single contact point for client service; and

d. Integrated Businesses permit adviser networks to combine with larger and better resourced and capitalised businesses. That connection can in turn translate to benefits to clients including:

i. a larger network of infrastructure to service client needs;

ii. a more connected interface between the client's adviser and the operator of the platform to ensure a more streamlined service and that client service is kept paramount;

iii. the peace of mind for clients associated with knowing that the combined business has the resources and infrastructure to deal with any issues that might arise with the advice or the operation of the platform;[8]

iv. the information technology systems which comprise a platform require substantial expenditure to build, maintain and innovate, and this is more efficiently and effectively done within an organisation with broad scale and scope;

[8] ASIC Report 562 Financial Advice: Vertically integrated institutions and conflicts of interest (January 2018), [8].

v. Integrated Businesses can often have larger and better resourced compliance and risk management frameworks (including fraud protection systems) which can again ensure greater protection and peace of mind for the client; and

vi. the larger business can drive efficiencies through its greater scale and ability to share back office services. Those efficiencies can in turn assist in ensuring the services provided by Integrated Business are as competitive as possible.

e. In Westpac's submission, the combination of those advantages can provide material benefits for clients of Integrated Businesses that may not be available to clients of smaller or 'independent' adviser businesses.

24. The interests of clients that obtain advice from BTFA and BTGL are appropriately protected, and the risk of any conflict arising from BTFG's ownership of platforms that might be recommended by its financial advisers to clients is appropriately managed, by:

a. the risk and compliance framework within BTFA and BTGL which includes a number of steps to prevent and detect instances of advice inconsistent with the best interests duty;[9]

b. a remuneration framework for financial advisers within BTFA which limits benefits to them of advising a client to take a BTFG platform over any other suitable platform;[10]

c. ensuring appropriate education and training on advice matters and ethical and professional obligations;[11]

d. developing technology-driven tools to assist in the provision of quality advice;[12]

e. providing remuneration incentives which encourage client focus and appropriate outcomes;[13]

f. ensuring that its remuneration framework does not incentivise financial advisers to give inappropriate advice or to recommend Westpac products in preference to any other;[14]

g. robust controls around the inclusion of products on the Authorised Products List (**APL**), and ensuring that advisers are able to easily refer clients to products which are not on the APL subject to a short approval step;[15]

h. having appropriate compliance and risk processes in place to prevent inappropriate advice being given (for example, paraplanning processes) and to detect it when it occurs (for example, through auditing and other surveillance); and

[9] Ex 2.101 First Wright Statement, [105]-[205].
[10] Ex 2.101 First Wright Statement, [216]-[218].
[11] Ex 2.101 First Wright Statement, [163]-[167], [197]
[12] Ex 2.101 First Wright Statement, [132]-[134], [168]-[171].
[13] Ex 2.101 First Wright Statement, [77], [217].
[14] Ex 2.101 First Wright Statement, [216]-[218].
[15] Ex 2.101 First Wright Statement, [148].

i. the Three Lines of Defence model which involves risk and compliance specialists who have a degree of structural separation from the business.[16] It also includes a risk monitoring system which analyses a range of key risk indicators to identify potential issues in relation to advice, and identifies advisers who may need further investigation or management.[17]

25. Financial advisers within Integrated Businesses must have the freedom to recommend a platform that they regard as suitable to the client's needs including those platforms that do not sit on the relevant APL of the advice business within the Integrated Business. Financial advisers should also not be in receipt of remuneration that could reasonably be expected to influence their choice to recommend BTFG's platforms over any other.

26. Across the industry and consistent with the platform's primary function as an administrative and custodial tool (rather than as an investment in its own right), financial advisers tend to use only one or two platforms rather than run multiple platforms across their many clients. Advisers are likely to continue to use large cost competitive platforms for efficiency purposes regardless of whether those platform businesses are vertically integrated.

Question 5: Why should a platform operator continue to receive a fee or rebate from a fund manager calculated by reference to the value of clients' 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? T1953.29-32

27. For post-FoFA arrangements, BT platforms do not continue to receive a fee or rebate from a fund manager calculated by reference to the value of client funds invested in the fund. In circumstances where any rebates are received in respect of post-FoFA arrangements, those rebates are passed on to clients in full. Where applicable, the platform receives a fee for the administration services it provides to fund managers.

28. For pre-FoFA grandfathered arrangements, the platforms operated by BTFG sought fees or rebates from fund managers to offset a proportion of the increasing compliance and regulatory costs which platforms were required to absorb each year. Manufacturers of managed funds benefited from platforms if they were included in the platform's menu of investment options (and in some cases also provided for a lower cost of investment to clients). These fees or rebates offset some of the costs of the platforms, which would otherwise have to be passed on to the clients of the platform operator.

Question 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 pf 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? T1953.34-40

29. This question requires a consideration of the role of platform providers in collecting a fee due to the adviser for provision of services to the client. The role of a platform is primarily to provide a custodial

[16] Ex 2.101 First Wright Statement, [109]-[110].
[17] Ex 2.101 First Wright Statement, [182]-[190].

arrangement and they only have a limited role in the relationship between a financial adviser and a client. Noting that the obligation to provide a service for any fee from the client rests with the advisers, platforms take steps to improve client awareness of these fees and provide protections that will assist in preventing clients from being charged fees for services they do not receive. Westpac considers that platforms have an important role in providing these services to clients. When a platform account is established, BTFG, as part of its account establishment procedures, obtains consent directly from the client for the deduction of any agreed fees. Further, the platforms operated by BTFG provide fee transparency in the following ways:

a. each BTFG platform lists in the transaction summary screen (which can be viewed by the client through the online portal) the adviser fees that are deducted from their accounts (both the date and amount); and

b. each BTFG platform issues periodic statements (depending on the platform, at least annually and sometimes quarterly) to the client that also summarise any transactions on the account, including any adviser fees deducted.

30. In addition, adviser fee monitoring is conducted across all accounts to identify adviser fees that are anomalous. Where material anomalies are detected through this monitoring, BTFG investigates including by contacting the financial adviser to obtain an explanation. If the investigation does not conclude that the fees have been appropriately charged, the fee is reversed and no further ongoing adviser fees are applied to that account. The contract between BTFG and any financial adviser or dealer group that is authorised to operate a client account also contains warranties that appropriate consent has been obtained for any adviser fees, requires them to keep a record of that consent and gives BTFG the right to demand production of the records of that consent at any time.

31. BTFG considers that these processes and controls are appropriate to protect the interests of clients, in circumstances where the agreement about fees is between the financial adviser and the client. Other than requiring advisers to verify that the service has been provided, placing the obligation to police fee recovery on the platform (which is really an administrative tool) would almost certainly increase the costs to those businesses which would in turn drive up the costs to clients of platform use. In our view the obligation is sensibly left with the client's advice licensee.

INAPPROPRIATE ADVICE AND IMPROPER CONDUCT

Question 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?: T1959.19-25

32. Remuneration and incentive policies that reward financial advisers need to operate within an appropriately designed and managed framework, with the requisite systems and controls. Consistent with the recommendations made following the review by Stephen Sedgwick AO into the Australian retail banking sector and set out in the Retail Banking Remuneration Review Report dated 19 April

2017 (**Sedgwick Report**),[18] provided appropriate systems and controls are in place, remuneration and incentive policies that indirectly reward financial advisers by reference to revenue generated for a licensee or employer do not create an unacceptable risk that financial advisers will prioritise the generation of revenue over the licensee's obligations to clients. It is appropriate, at the outset, to distinguish different sources of revenue which may be received from clients and the ways in which advisers are remunerated across the financial advice industry and to describe the control measures which may be implemented to reduce the risk that financial incentives may cause inappropriate advice.

33. Financial advisers charge clients fees for the advice they provide, including plan and implementation fees. Plan fees are charged for the time and effort the adviser spends on developing a financial plan tailored to the client's personal circumstances and objectives. Implementation fees are paid by the client for the implementation of the adviser's plan where the client decides that they wish to proceed to implement the plan.

34. These kinds of advice fees are directly referrable to the provision of a service by the adviser and in this sense are akin to the fees charged by other professionals for the advice they provide to their clients. Clients pay advice fees for advice provided by advisers whether the adviser is employed or authorised by a large financial services licensee which also manufacturers financial products or by an adviser operating by themselves or as part of a small practice authorised by a smaller licensee. Westpac submits that advice fees do not give rise to conflicts between an adviser's financial interests and those of the client. Rather, if anything, plan fees incentivise an adviser to provide advice to more clients and implementation fees incentivise an adviser to provide quality advice which their clients wish to implement. Advisers are also incentivised to provide quality advice to clients in the expectation that this is more likely to lead to the establishment of ongoing relationships with clients, repeat business and referrals.

35. Revenue is also generated by financial advisers through payments paid by product providers (**product payments**). These kinds of product payments may be paid to advisers employed or authorised by a large licensee who is also a product provider (including by product providers other than the adviser's employer) and to advisers who operate by themselves or as part of a small practice authorised by a smaller licensee. Westpac acknowledges that product payments have the potential to influence financial advice and thereby create a risk of advisers prioritising their own interests over their clients' interests, but that this risk can be controlled through appropriate systems and processes such as those outlined in paragraph 37 below.

36. Similar to other industries in which fees are charged for the provision of services, remuneration of financial advisers by reference to the revenue they generate is common in the financial advice industry. Financial advisers who operate by themselves or as part of a small practice authorised by a smaller licensee typically receive all of the revenue they generate, including from advice fees and product payments, possibly without being subject to the same eligibility criteria and level of compliance controls as advisers employed by large licensees (as described below). Financial

[18] Stephen Sedgwick AO, Retail Banking Remuneration Review Report (19 April 2017) ("*Sedgwick Report*"). See https://www.betterbanking.net.au/wp-content/uploads/2018/01/FINAL_Rem-Review-Report.pdf

advisers who are employed by large licensees are commonly remunerated in part through the payment of bonuses which are calculated by reference to a share of the revenue the adviser generates above certain targets.

37. While remuneration practices alone could not wholly prevent the provision of inappropriate advice regardless of whether some component of pay was linked to revenue, remuneration practices such as those employed at Westpac can control the risk that financial incentives may cause poor advice and can materially increase the prospect of compliance with policies and processes. Examples of remuneration practices that may be implemented to reduce the risks that financial incentives may cause poor advice include:

    a. remuneration oversight committees responsible for implementing and managing the remuneration practices and compliance controls within which advisers operate;

    b. compliance and behavioural "gate openers" which advisers must satisfy to be eligible to receive bonuses or which may affect the timing of payment of bonuses;

    c. policies and practices which result in the revenue contributing to calculation of an adviser's bonus being reduced (including to zero) for compliance incidents, such as where a complaint is received and the adviser is determined to be at fault or where an insurance commission is clawed back as a result of the insurance policy lapsing or being cancelled within a particular period; and

    d. the use of balanced scorecards, in which the revenue generated by an adviser is not the dominant component for performance assessment.

38. Westpac's current remuneration framework for employed advisers includes the control measures identified in paragraph 37.a to 37.d above and in September 2017, Westpac decided to implement a new adviser remuneration framework, described further below, which shifts incentives away from a share of revenue model towards a balanced scorecard approach, to bolster its approach to minimising the risk of incentives driving poor behaviour.

39. The steps Westpac takes to prevent and detect inappropriate advice include compliance audits, mandatory paraplanning and pre-vetting, regional manager supervision and its Planner Risk Insights (**PRI**) data analytics system.[19] These measures provide an incentive for advisers to provide appropriate advice, because they may result in the adviser being subject to remedial or disciplinary action (such as suspension or termination for a breach of their employment agreement).[20] These controls also augment education and training systems, and thorough recruitment and performance review processes, all of which assist in ensuring that remuneration frameworks properly incentivise good behaviour and disincentivise bad behaviour.[21]

[19] Ex 2.101 First Wright Statement, [51].
[20] Ex 2.101 First Wright Statement, [83].
[21] Ex 2.101 First Wright Statement, [28]-[32], [34]-[49], [83]; see also answers to Questions 18 and 19.

40. Where particular fee or product payments might potentially increase the risk of inappropriate advice, this can be managed through targeted policies and reforms. For example, in relation to insurance products exempted from the conflicted remuneration provisions, prior to 1 January 2018, Westpac (as was common in the industry) applied a 12-month clawback period to the purchase of insurance products (on a tiered basis). Incoming reforms have increased the clawback to 24 months, and significantly altered the upfront and trail commission structures for those products.[22] These reforms will discourage financial advisers from advising their clients to take up insurance products they do not need. Since 2015, Westpac has also taken proactive steps in prohibiting employed advisers from acting on execution-only instructions for primary issuances, and requiring that stamping fees paid to it by issuers as part of primary issuances of securities be directed towards a professional standards fund to support adviser training and capability initiatives.[23]

41. There are aspects to variable reward schemes (referable in part to revenue generation) that are beneficial to consumers and financial advice businesses and the industry as a whole. These include that:

    a. advisers are incentivised to provide a quality service so as to form ongoing relationships with clients, receive repeat business and receive referrals (and thereby increase their remuneration);

    b. such schemes limit the amount of revenue received by financial advisers and control the compliance environment in which it is received, recognising that the alternative may be that financial advisers – for example, by practicing on their own – receive all, or a much larger share of the revenue they generate, while not being subject to the more rigorous compliance controls maintained by larger organisations like Westpac; and

    c. it enables Westpac to attract and retain the best possible financial advisers in the industry where they may otherwise seek to establish their own practice.

42. Westpac recognises that there is a potential risk of conflict with unqualified share of revenue remuneration models. As such, in September 2017, Westpac decided to move to a model in which employed financial advisers would be remunerated by way of a salary and, for those who qualify, a bonus calculated by reference to a variable reward target which is fixed for different adviser levels having regard to the skills and qualifications of advisers at that level. Westpac's work on that framework is substantially progressed and will involve an adviser's eligibility to receive a bonus payment and the amount of that payment being determined by their performance against a balanced scorecard. The balanced scorecard is weighted overwhelmingly towards non-financial measures. Eligibility to receive a bonus will continue to be conditional on satisfaction of risk, compliance and behavioural gate openers. Further, to be eligible for any variable reward at all, advisers will have to meet an acceptable level of performance in the non-financial components. Additionally, through the weighting in the balanced scorecard an adviser can be rewarded without achievement of the financial component.

[22] T1454.20-24; Ex 2.10 Third Wright Statement, [18].
[23] First Wright Statement at [145]-[146].

Question 8: How can financial services licensees best incentivise the provision of good quality advice, including in situations where the best advice for a customer is not to change anything at all? T1959.27-29

43. Westpac's response to Question 7 largely describes the ways in which the risks of advisers providing poor advice can be managed and how Westpac seeks to manage these risks. Westpac also recognises the need to ensure that advisers are incentivised to provide *good* advice, which could include in some circumstances advising a client to retain their existing investment strategy.[24]

44. Westpac believes that licensees can best incentivise the provision of good quality advice through the use of remuneration practices that focus predominantly on good client outcomes and on the promotion of the behaviours, skills and qualifications most likely to lead to good quality advice. Eligibility to receive any variable remuneration would be conditional on satisfaction of compliance and behavioural gate openers. These considerations underpin Westpac's proposed new adviser remuneration framework described in the response to Question 7 above.

45. In Westpac's view it is appropriate for financial measures to remain part of any scorecard used to assess variable reward for the reasons outlined in paragraph 42 above.[25] By limiting the financial component of a variable reward scheme, and adopting a balanced scorecard, advisers can be appropriately rewarded for contributing to the financial success of the business provided that they have done so appropriately, including by acting in the best interests of the client. This may be compared with the position of financial advisers who are self-employed or operate as part of a small practice, whose remuneration is typically a simple function of 100% of the revenue they generate less their costs.

46. An approach of the kind outlined above is also consistent with the recommendations made in the Sedgwick Report. The report recommended that variable reward be based on a holistic assessment of performance (rather than solely on revenue). This could be achieved through the use of balanced scorecards in which revenue is not "the dominant component".[26] The Sedgwick Report noted that its recommendations were consistent with similar developments in the UK that resulted in "improved client outcomes and strengthened individual behaviour."[27]

47. Licensees may also incentivise the provision of good quality advice by recognising strong compliance records and client outcomes when promoting and rewarding advisers.

Question 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? T1959.29-32

48. Westpac acknowledges and accepts that licensees are responsible to put in place and administer appropriate processes to prevent inappropriate advice from occurring, identify problematic issues occurring in the business and fix them as soon as possible. Potential risks to clients that are

[24] T1410.34-43; T1411.4-10.
[25] T1451.39-45; T1452.4-10.
[26] Sedgwick Report, 7.
[27] Sedgwick Report, 7.

identified through the results of routine compliance measures (such as compliance audits, PRI alerts and Regional Manager customer care calls) can be managed and appropriately escalated in a timely manner through a framework that has three key elements:

a. (**Governance**) comprising appropriate risk management, compliance assurance arrangements and good governance frameworks that should be embedded across licensees. This can be achieved by: having appropriate monitoring structures, such as dedicated business units (including investigations and monitoring and supervision) that sit outside of normal operations; maintaining a three lines of defence risk model with second and third line oversight; being clear on individual roles, responsibilities and accountability; actively monitoring, evaluating and using management information and feedback about processes and responding appropriately; and escalating issues and misconduct in a timely manner and maintaining a robust governance framework, such as appropriate management forums, that leads to appropriate resulting action being taken.

b. (**People**) recruiting and authorising the right people and investing in their development through coaching and training programs. This can be achieved by: maintaining remuneration and incentive arrangements that are balanced; developing, implementing and maintaining leading cultural practices (including communication and leadership); recruitment (including role design); capability, behavioural and technical training and accreditation; and management of performance, including through compliance audits, manager supervision, remuneration and rewards and consequence management.

c. (**Processes**) adopting processes and tools that are efficient in identifying risks, effective in meeting business objectives, appropriate for the people using them, and are well controlled and monitored to deliver suitable, fair and clear outcomes for clients in a fair and timely manner. This can be achieved through: designing and reviewing policies appropriate for the ends they seek to achieve; adequately investing in systems to proactively identify and manage conduct risk (such as paraplanning, pre-vetting, compliance audits, and PRI), including so that licensees can intervene before conduct risk crystallises; sound incident management processes; fixing wrongs expeditiously and incorporating learnings to improve processes; and communicating clearly with clients to assist clients to make good decisions, backed up by adequate records and data management.

49. A key aspect of ensuring that risks to clients are identified in a timely manner is taking protective steps whilst escalation processes, such as investigations, are conducted, that may include additional controls and potential suspension. Westpac discusses these matters in response to Question 12 below.

50. Further, it is critical that there is an effective feedback loop, so that learnings through compliance monitoring processes can be aggregated over time and over planners and assessed to detect and address systemic issues that may arise. For Westpac this is facilitated through functions such as the risk forums and committees which are able to implement or recommend changes to policy and process or individual consequences where issues are identified.

51. Westpac believes that its system has the elements described above, which have been set out in detail in Mr Wright's evidence,[28] and Westpac's submissions to the Commission on 29 January and 13 February 2018. However, Westpac is committed to constantly engaging in feedback and self-analysis, so that escalation processes are functioning properly and always improving.

Question 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? T1969.26-28

Question 11: Are improvements in technology the only way to ensure that financial advisers provide quality advice? T1969.30-31

52. It is convenient to address Questions 10 and 11 together.

53. Westpac's experience has been that improvements in technology, together with a move towards electronic storage of client advice files in a standardised format on a central system, have significantly improved Westpac's ability to ensure, in a cost-effective manner, that its financial advisers provide comprehensive quality advice. For example, the automated data analysis carried out by Westpac's PRI system[29] flags instances of outlier behaviour across a volume of files that could never be the subject of a cost-efficient audit process. The conduct that was the subject of the case study involving Westpac's former financial planner, Mr Andrew Smith, was identified as the result of an automatic alert initially raised by the PRI system.[30]

54. Similarly, Westpac's experience has been that requiring its employed financial advisers to store their advice in a standard form on a centralised system (Westpac's Customer File Management (**CFM**) system)[31] has improved its ability to ensure that financial advisers keep appropriate records to support the advice they give. Storing documents in the CFM is now an important part of Westpac's control environment.[32] Compulsory, centralised storage of advice documents in electronic form also allows supervisors to inspect those files easily and, if necessary, without notice to the adviser.

55. That said, Westpac regards it as unlikely in the short to medium term that improvements in technology will completely replace the need for traditional or manual controls in relation to the provision of financial advice. In the main part, that arises from the idiosyncratic nature of financial advice. There is also likely to remain a need for an element of human supervision (and initiative) to avoid the potential for employees to game a wholly automated system.

56. Westpac does not submit that it is impossible for financial services licensees to adequately monitor advice in a manual environment. Nor does Westpac submit that improvements in technology are the only way to ensure that financial advisers provide quality advice. The answers to those questions may well depend on the size and nature of a given financial advice business. For an organisation

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[28] Ex 2.101 First Wright Statement, [54], [104] – [205]
[29] See Ex 2.101 First Wright Statement, [182]-[190] for an overview of the PRI system.
[30] Ex 2.101 First Wright Statement, [337].
[31] See T1426.18-20 and Ex 2.101 First Wright Statement, [178]-[179] for a description of the CFM system.
[32] T1426.22-23.

such as Westpac, reliance on improvements in technology is an important element of seeking to provide its clients with affordable, quality advice.

Question 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? T1969.31-33

57. Protecting clients while a practitioner is the subject of a complaint or suspected issue, while also affording the individual who is the subject of the complaint fairness, is an issue faced by many industries and can be difficult to manage. While there is no one size fits all approach, the mechanism should in all circumstances err on the side of customer protection. Westpac is of the view that clients' interests should be protected during the course of an investigation by putting in place appropriate measures to understand and manage the particular risk which the situation represents which, in turn, involves the expedited preliminary assessment of the issue and the nature of the risks to the clients, prioritising investigatory activities according to potential harm and implementing appropriate protective measures. Westpac's position is that an adviser should be suspended from giving financial advice pending the outcome of an investigation if there is a risk that cannot be reasonably ameliorated that clients' interests are in jeopardy while the investigation is conducted. Suspension while the investigation progresses though may not be necessary in circumstances where the risk of harm to the client can reasonably and confidently be assessed as lower or capable of safe management. Some of the mechanisms by which the client can be protected during that phase may include added supervision, training, or pre-vetting of advice.

58. As the investigation process proceeds, the risk to the client should be periodically reassessed to determine whether the measures that have been imposed remain adequate and/or need to be altered to better reflect any change in the risks.

Question 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? What connection is there between an associated level of risk and the identification, investigation and remediation of inappropriate advice? T1969.34-39

59. There are differences between the risk that is acceptable to an individual client, the risk that can be reasonably expected in large and complex environments and the risk that is acceptable to the community as a whole.

60. Each of Westpac's clients is entitled to expect that he or she will be given quality, appropriate advice on every occasion that he or she deals with a Westpac financial adviser. That is the basis on which Westpac is committed to dealing with its clients.

61. Given the provision of financial advice is complex, often subjective and provided by persons who can and do make mistakes, it is inevitable that there will be some risk of clients being provided with inappropriate advice. This is the case even in established professions. While it might be theoretically possible to reduce the level of the risk to close to zero, for example through the requirement to have an external audit of every piece of advice, this would likely require the implementation of an

administratively unworkable system that would in turn make financial advice inaccessible and cost prohibitive. The most important consideration then is that licensees do all things reasonably necessary to ensure the risk is reduced as far as possible and that it has quality systems in place to deal with problems where they occur. That risk should be reduced as much as it can be, whilst providing a service that is most cost-effective to the client. Licensees should aim for high confidence in error detection and be resourced and willing to promptly remediate clients in instances where it is identified that they have suffered loss as a result of inappropriate advice. New technologies should be embraced as they emerge to help achieve those goals as should the moves to further professionalise and add individual responsibility to planners as outlined in response to Questions 22 and 23 below.

Question 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? T1976.30-32

62. Westpac is of the view a client (or former client) should be informed as soon as practical after it has been identified that the client has suffered loss as a result of inappropriate advice or is at risk of suffering loss as a result of identified inappropriate advice.

63. There will be no single answer as to what constitutes "as soon as practical" but, generally speaking, Westpac is of the view that it should be as short as possible and consistent with the client's right to understand issues that may adversely affect them. The factors that will affect that length of time include the time required to prepare for a meaningful meeting with the client (given notification normally includes an invitation to discuss the client's situation) and whether the client's case forms part of a broader review or remediation programme where a common approach is necessary.

Question 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? T1976.32-35

64. Westpac is committed to providing timely compensation when its clients suffer loss as a result of inappropriate financial advice given by its advisers.

65. Each case is different and it is not possible to be more specific than to say that adequate compensation should be offered to the client as soon as reasonably possible after it has been identified that the client has suffered loss caused by inappropriate financial advice.[33] A number of considerations will affect how long a reasonable period is in any given case, including: the complexity of the advice; the difficulty of assessing the client's loss; the time taken by the client to provide necessary information (where requested); the date of the advice; the quality of the file; the duration of time between the alleged conduct and the complaint being raised; and the quality of records

[33] Westpac notes it developed company-wide remediation guidelines, which have been used in practice as a reference across the Group for some time. Westpac had regard to ASIC's Regulatory Guide 256 'Client review and remediation conducted by advice licensees' (September 2016). RG 256 addresses remediation for clients who receive personal advice, when developing these guidelines. Key elements of these guidelines include active communications with impacted customers and prompt remediation efforts. In the advice business, this translates into requiring timely engagement with, and remediation of, clients that have suffered loss as a result of receiving inappropriate advice. Recently these guidelines were converted into a Remediation Policy and were formally approved by the Group Executive Risk Committee.

available to assess the complaint. A further significant driver is whether the client's case forms part of a broader review or remediation programme.

Question 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? T1979.45 - T1980.1

66. Westpac believes the key to achieving this balance is to encourage self-reporting of mistakes, including by giving employees visibility of the benefits of self-reporting, and to ensure that employees know they will be dealt with fairly when an issue arises, including by hearing the employee's side of the story. Financial advice involves people, and people make mistakes and sometimes do the wrong thing. Employees should know their employer understands that and, while that will not excuse poor behaviour, the consequences imposed by their employer will have regard to it.

67. Westpac has performance frameworks and policies in place that try to achieve the right balance. The Westpac Group's Risk Adjusted Reward Framework requires adjustments to be made for both material *positive* and negative behaviours. Examples of positive behaviour identified in the Framework are "Self-identifying risks and increasing risk awareness" and "Safe to speak up", which encourage self-reporting of mistakes. Westpac also has in place an anonymised reporting process to create a safe environment for staff to escalate issues.

68. Westpac's performance and reward framework (called "Motivate") is underpinned by the growth mindset, which is centred on a 'behaviours first' approach. This means every performance conversation should start with a discussion around behaviours, reinforcing that 'how' you deliver is just as important as 'what' you deliver, and regular check in conversations to ensure continuous improvement.

Question 17: How should financial services licensees recognise and reward ethical conduct by financial advisers? T1980.1-2

69. As previously noted, there is an appropriate balance to strike between incentivising good, ethical behaviour, and disciplining the bad. Licensees should recognise and reward ethical conduct by making the variable component of remuneration: (a) conditional upon compliance and meeting ethical standards and values set by the institution; and (b) setting remuneration by reference to client-centric measures that are likely to reflect ethical conduct and good quality advice (see responses to Questions 7 and 8 above regarding remuneration).

70. Licensees should also be proactive in developing and implementing tools which enable them to accurately measure indicators of good advice and ethical conduct, such as client engagement and feedback, so that these measures may be used in a meaningful way to inform adviser remuneration and performance assessment. Westpac has in recent years developed several tools to measure direct client feedback and engagement. By way of example, in 2015 Westpac launched "BT Adviser View", which is an online portal that allows clients to research advisers employed by Westpac and to

rate and provide feedback in respect of their experience with an adviser.[34] Client engagement and feedback derived from tools such as BT Adviser View may be used to inform balanced scorecards against which the performance of advisers is assessed and their remuneration set.

71. The vast majority of BTFG's financial advisers (and those in the wider industry) are ethical people committed to providing their clients with the best possible advice. Nevertheless, Westpac believes that ethical conduct should be proactively encouraged by balancing the above incentives with: (a) a focus on retaining advisers with a strong compliance background, and maintaining an ethics-focussed ongoing education of financial advisers (see responses to Questions 19 and 20 below regarding retention and education/training); and, (b) imposing immediate consequences and maintaining a "zero-tolerance policy" in relation to unethical conduct (see responses to Questions 19, 20, 22 and 23 below regarding disciplinary processes).

Question 18: 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 the issue? T1980.2-5

72. Like many industries, improper and unethical conduct occurs in the financial advice industry. Westpac has made changes aimed at minimising the occurrence of this conduct and continues to make further changes. Changes introduced with the FoFA reforms have substantially improved the position as have general industry reforms on standards and conflicts of interest. Westpac is also in the process of introducing further changes, including changes to its remuneration structures aimed at managing any perceived conflicts of interest and reducing the potential risk of improper, unethical or dishonest conduct by financial advisers.

73. The problem is not restricted to financial advisers employed or authorised by the big four banks and AMP, who combined represent approximately 30% of financial advisers in the industry. The evidence before the Commission concerning Henderson Maxwell and Dover Financial Advisers makes that much clear.

74. While accepting that there are issues, there is not a reasonable basis to conclude that there is any material higher incidence of improper, unethical or dishonest conduct in the financial advice industry than in other industries. In fact, the financial advice industry is subject to a higher degree of regulation and oversight than most other industries or professions. There is an external regulator and little or no self-regulation of the type found in some professions. The requirements on licensees to report instances of their own contraventions of the Act, such as in s. 912D,do not have analogues in most other professions. Those matters may contribute to a higher rate of reporting in the financial advice industry than in other industries or professions. That is a good thing, but it may make conclusions drawn from comparisons with other industries or professions, based on anecdotal evidence, incorrect.

75. Mr Wright gave at least two pieces of evidence that might assist the Commission on this issue. The first was that the financial advice industry, which is a relatively immature industry, is "on the cusp" of

[34] Ex 2.101 First Wright Statement, [191]-[192].

becoming a true profession but, implicitly, is not there yet.[35] Secondly, when asked why the public did not place their trust in financial advisers in the same way that they place their trust in other professions, like doctors and lawyers, Mr Wright said that that trust had not yet been earned by the financial advice industry.[36] The trust that some professionals enjoy is the product of a 'virtuous circle' in which education, training and knowledge play an important part.

76. The potential exists for financial advisers to earn the respect accorded to other professions. Financial advisers have the ability to help clients with important decisions about their financial futures. In the increasingly complicated financial environment that exists today, the ability to make those decisions without expert assistance is moving beyond the reach of most Australians. One objective should be to create a culture that focuses on the importance of advisers building longstanding relationships with clients, learning and training, encourages financial advisers to take pride in their professional knowledge and expertise and recognises, for its own worth, the giving of good financial advice. Westpac is seeking to do that as outlined in its responses to Questions 19, 20, 22 and 23 below.[37]

DISCIPLINARY PROCESSES IN THE FINANCIAL ADVICE INDUSTRY

Question 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? T1984.44-46

77. BTFG is a founding subscriber to the Australian Banking Association (**ABA**) Reference Checking & Information Sharing protocol (**ABA Protocol**) which came into effect on 1 March 2017.[38] BTFG welcomed the introduction of the ABA Protocol as a means to proactively ensure better information sharing between licensees during the recruitment of advisers. BTFG was a leader in seeking a standardised approach to adviser reference checking and also the instigator of the industry reference checking reforms. BTFG has incorporated the ABA Protocol into its recruitment process since its inception.[39]

78. Under the ABA Protocol, BTFG asks for and provides information including: whether an adviser has been reported to ASIC; material incidents including significant complaints;[40] investigations in progress at the time of the adviser's resignation/termination; and audit history.

79. Prior to the introduction of the ABA Protocol, information sharing between licensees was inconsistent and challenging. BTFG believes that the ABA Protocol has significantly improved these challenges and assists subscribing licensees to make informed recruitment decisions. Notwithstanding that, BTFG also notes that the Protocol: (a) as presently formulated requires improvements to operate at its maximum potential; (b) inherently has its own limitations and requires a balance of competing interests; and (c) therefore should supplement, and co-exist with, individual licensees' control

[35] T1444.40-42.
[36] T1445.14.
[37] T1444.31-36.
[38] Ex 2.117 ABA Banking Industry Conduct Background Check Protocol [RCD.0021.0003.0009]; Ex 2.101 First Wright Statement, Ex MW-1, Tab 16 [WBC.502.001.0443].
[39] Ex 2.101 First Wright Statement, [38].
[40] BTFG elects to disclose all complaints including the dollar value so that the requesting licensee can determine materiality and significance although the protocol requires disclosure of material incidents only.

environment, including recruitment processes that adequately screen and on-board individual advisers.

80. The ABA Protocol as presently formulated requires improvements, some of which are already underway. These include:

    a. Incorporating conduct and background check questions. This will assist licensees in forming a more detailed picture of an adviser's conduct and compliance history.[41]

    b. Making information-sharing mandatory for all industry participants.[42] Currently the ABA Protocol requires information sharing between subscribing licensees only.[43] Extending the ABA Protocol to all participants to make information sharing mandatory will assist in levelling the playing field, and improving the quality of recruitment across the industry, by allowing all licensees to make recruitment decisions based on consistent and complete information. This could be done either through legislation or a broader agreement amongst industry participants under an industry code of practice.

    c. Standardising terms of reference and definitions of materiality to assist in the consistent assessment of candidates. There is substantial diversity as to how licensees monitor and assess their advisers including the frequency and rating scale of compliance and audit reviews and the materiality of complaints. Standardising these matters would likely improve the extent to which recipient licensees can interpret and understand the nature of the information that has been provided to them, and make the appropriate recruiting decisions accordingly.

    d. Implementing further safeguards to address concerns about legal action against licensees arising from the provision of unverified information or information about ongoing investigations in order to facilitate greater information sharing between licensees. Prior to the introduction of the ABA Protocol, and as canvassed in the case study regarding Andrew Smith, BTFG provided verbal disclosures of compliance concerns to recruiting licensees – which while deficient by today's standards – reflected a genuine concern at the time (and which to some extent remains) about providing unverified information given the significant legal risks that may arise from that disclosure (e.g. such as defamation, privacy/confidentiality concerns etc.)[44] Although the ABA Protocol allows for information to be shared on a confidential basis,[45] BTFG retains concerns about providing unverified information to other licensees and is particularly concerned about potential defamation risks with doing so. These risks could potentially be mitigated or reduced by legislative reforms.

81. However, even if these and other improvements were to be adopted, the ABA Protocol should not be viewed as a complete solution to the recruitment of unsuitable advisers. The current inherent limitations in the system arising from the need to balance consumer protection against the rights of

[41] For example, BTFG understands that the ABA, as part of its post-implementation review, is presently considering, *inter alia,* incorporating conduct and background check questions into adviser checks and providing subscribers clarifying guidance on materiality and compliance/non-compliance issues.
[42] Cf. Ex 2.117 ABA Banking Industry Conduct Background Check Protocol [RCD.0021.0003.0009] at .0010.
[43] Ex 2.117 ABA Banking Industry Conduct Background Check Protocol [RCD.0021.0003.0009] at .0011.
[44] T1462.13-17.
[45] Ex 2.117 ABA Banking Industry Conduct Background Check Protocol [RCD.0021.0003.0009] at .0009, .0013.

advisers' and the legal liability of subscribers, particularly in relation to investigations which have not yet concluded, will likely always remain to some extent.

82. Accordingly, while the ABA Protocol once refined is as adequate as a system of its nature can be, BTFG submits that the information obtained should not be relied on in isolation by any ABA Protocol subscriber. Licensees should have in place robust and effective controls throughout their entire recruitment and selection process to minimise the risk that they will hire unsuitable advisers.[46]

Question 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? T1984.46 - T1985.2

83. Licensees, including Magnitude and Securitor, are required to maintain a minimum degree of satisfaction as to the competence and integrity of applicants to become authorised representatives. The minimum obligations imposed on licensees to ensure their authorised representatives are "competent" and "adequately trained" are legislatively mandated as part of licensee obligations pursuant to – at least – sections 912A(1)(e) and (f) of the Corporations Act.

84. BTGL meets its obligations to ensure the competency and integrity of authorised representatives before authorising them, in four key ways:

    a. (**Pre-authorisation checks**) authorised representatives undergo a full pre-authorisation check at onboarding, which includes, for instance, completion of an industry reference checking form (see Question 18 above re ABA reference checking protocol), previous compliance audit reports and compliance references, due diligence reports (including police and credit checks); ASIC Register checks, internet checks, direct report references, and role specific accreditations and any other training.[47]

    b. (**Qualifications**) from 1 January 2019, BTGL will not hire new to industry financial advisers who do not possess a relevant degree or have not completed an approved alternative pathway conforming to the Financial Adviser Standards and Ethics Authority (**FASEA**) standards, and from 1 January 2024, this requirement will apply to existing financial advisers.[48] Currently, BTGL financial advisers are required to:

        i. be compliant with ASIC's Regulatory Guide 146. This involves training on specialist knowledge areas relevant to the particular adviser's role.[49]

        ii. complete all specific accreditations and any other training required for the role including:

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[46] Ex 2.101 First Wright Statement, [34]-[43] (regarding recruitment and pre-authorisation checks) and [44]-[49] (regarding BTFG's induction programs).
[47] Ex 2.101 First Wright Statement, [37], [38]-[43].
[48] Ex 2.101 First Wright Statement, [32].
[49] Ex 2.101 First Wright Statement, [28].

(A) mandatory accreditations, such as anti-money laundering and counter-terrorism financing legislation training, privacy, consumer protection, fee disclosure obligations, best interest obligations, renewing ongoing advice and conflicted remuneration obligations accreditation;[50]

(B) compliance accreditations;[51] and

(C) role specific accreditations. For example, depending on the role BTGL advisers may be required to have accreditation in listed securities, gearing and margin lending, and self-managed super funds.[52]

c. (**Due Diligence**) since 2014, BTGL has conducted due diligence checks on practices and corporate authorised representatives before individual authorised representatives become authorised under the Magnitude and Securitor licenses[53] (as opposed to existing practices).

d. (**Induction**) BTGL also conducts an induction program. The BTGL program is tailored to ensure that all authorised representatives have an understanding of their licensee's standards, policies, and compliance framework, as well as the full gamut of support teams that assist them in making the right choices in the best interests of their clients. These include, research, technical services, education, product, technology and practice management support teams.[54]

85. Pre-authorisation checks are crucial to maintaining a minimum degree of satisfaction as to the competence and integrity of applicants, however just as important is the ongoing training, education and monitoring of authorised representatives once authorised. This is not only because Westpac's licensee obligations are ongoing, but also because recruitment processes will necessarily carry the same level of "bad apple" risk, as other compliance controls. Accordingly, Westpac believes that licensees can meet or exceed their ongoing obligations including by requiring that authorised representatives:

a. undergo at least 40 CPD hours each year, including five hours of ethics training. Training should be structured to align with particular areas of authorisation of the adviser. This training should also be tested to uphold standards;

b. meet the education standards set by FASEA and be compliant with the ASIC RG 146;

c. undertake annual ongoing training in key legal obligations for advisers;

d. complete compliance audit checks satisfactorily; and

[50] Ex 2.101 First Wright Statement, [28].
[51] Ex 2.101 First Wright Statement, [28].
[52] Ex 2.101 First Wright Statement, [28].
[53] Ex 2.101 First Wright Statement, [40].
[54] Ex 2.101 First Wright Statement, [47].

e. be subject to pre-vetting, requiring all draft advice documents to be reviewed for consistency with standards and requirements before it is finalised.[55]

86. Authorised representatives could also be required to maintain membership of an industry body or association (with costs ideally to be reimbursed by employers to encourage membership). Ensuring that the FPA, for example, is a well-resourced, self-regulating professional body is key to "professionalising" the financial advice industry.[56]

Question 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? T1985.43-46

87. Section 912A of the Corporations Act and, in particular, the requirement under sub section (1)(a) of that provision that financial service licensees do all things necessary to ensure that their services are provided 'efficiently, honestly and fairly' provides an important normative structure and framework by which financial services licensees are obliged to regulate their conduct.

88. Section 912A outlines key supervisory obligations for licensees, the breach of which could result in the cancellation of the licence or the imposition of conditions on the licensee. Other than those very serious consequences for a licensee associated with its observance of section 912A, the section does not have any other particular penalty associated with it. The other major function of section 912A is to act as the trigger as to when it is necessary for the licensee to inform the regulator of a significant issue with its compliance with the law or with the normative standard of conduct expected.

89. Given the key purpose of section 912A - to set a subjective benchmark moral standard of behaviour which the licensee regulator is to be informed of if the licensee fails, Westpac is of the view that 912A is reasonably framed and effective in imposing a general standard of conduct which Westpac seeks to adhere to or exceed. The section 912A(1) standard informs conduct at Westpac and Westpac takes very seriously both the need to adhere to the standard and to report significant deviations from it. An example of how the section operates subjectively is seen in ASIC's interpretation that the 'efficiently, honestly and fairly' obligation may be understood, in cases where ambiguity exists, by reference to 'good industry practice'.[57] In considering section 912A it is worth remembering that it coexists with a comprehensive regime of other financial services laws, many of which have specific and severe penalties associated with them (both for the licensee and any individuals involved). Section 912A is intended to perform a broader more overarching purpose.

90. Section 912A can be and is enforced by ASIC. ASIC's enquiries into breaches of the section 912A standard and considerations of that kind regularly inform decisions around changes to products, systems and processes and compensation. Where ASIC and the licensee are in disagreement about whether any conduct is incompatible with section 912A, ASIC may take action to enforce the standard. Very few such cases have found their way to final determination by a court which suggests that the parameters of the provision in its current operation are reasonably well understood.

[55] Ex 2.101 First Wright Statement, [29].
[56] T1412.1-4; T1444.24-36.
[57] See ASIC Regulatory Guide 104 (RG 104.15)

91. In short, section 912A as currently drafted, plays a central role in regulating licensee conduct and, due to its interaction with the self-reporting obligation in section 912D, in ensuring that the regulator is apprised of significant breaches in the standard.

92. Westpac notes that the ASIC Enforcement Review Taskforce has recommended that section 912A be made a civil penalty provision.[58] Assuming that recommendation results in legislative amendment, much more specific consideration would need to be given as to whether the more subjective elements of section 912A such as 'efficiently', 'fairly' and 'all things necessary' are sufficiently clear to support the imposition of a specific penalty (i.e. other than potential license consequences). The concept of "reasonable steps", and doing "all things necessary", – if an absolute standard is to be applied – would be impossible to meet.[59] "Efficiency and fairness" would need to be particularised and tied to measurable, practical and achievable standards for licensees.[60]

93. That is to say, while section 912A operates effectively in its current form and in the manner in which it interacts with the other financial services laws, if its surrounding environment and uses were to change – for instance if it was to become an overarching catch-all provision to which civil penalties attached – more would need to be done so that compliance with the section can be objectively measured and established.

94. Section 912A operates effectively as it is currently framed. It is sufficiently general and specific to encourage good communication between licensees and ASIC and works well in conjunction with the other framework of financial services laws to which penalties and other specific sanctions already apply. If civil penalties are to be introduced, however, the section will require revision to ensure fairness to licensees and enable proper enforcement by the regulator.

Question 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? T1985.46 - T1986.2

Question 23: Does the division of responsibility create gaps in the disciplinary system? If so, what are they? T1986.4-5

95. It is convenient to address Questions 22 and 23 together.

96. Westpac believes that the current division of responsibility does create gaps that reduce the effectiveness of the regulatory and disciplinary regime. Westpac supports reforming the current regulatory and professional association framework to address gaps (and in some cases overlap) between the responsibility for licensing and authorisation, education levels, standard-setting,

[58] A recommendation that has been accepted by the Australian Government in its response to the ASIC Enforcement Review Taskforce Report (December 2017) ('*ASIC Enforcement Review Taskforce Report*'): see Australian Government, *Australian Government response to the ASIC Enforcement Review Taskforce Report*, (April 2018), Recommendation 43, 12.
[59] See Westpac Banking Corporation, Submissions on Financial Advice Case Study (4 May 2018) [54]-[55].
[60] This also has been noted in the ASIC Enforcement Review Taskforce Report, 5. Westpac also notes that ASIC has also recommended that a code-monitoring body (in relation to industry codes to which licensees subscribe) be empowered to escalate potential breaches of s. 912A for investigation by ASIC. A recommendation agreed, in principle, by the Australian Government but deferring to the findings and recommendations of this Commission: see ASIC Enforcement Review Taskforce Report, Recommendation 22, 35.

professional development, monitoring, enforcement and professional discipline. This could include, as suggested in Westpac's response to Question 24 below, a system for the professional discipline of financial advisers managed through a single body (such as a FASEA type body with expanded powers).

97. Westpac advocates the need to adapt the current regulatory model so that it more closely resembles the manner in which other professions are regulated and, specifically, has advocated the introduction of a central regulatory body, funded by the profession and given authority under the Corporations Act to perform its role. This could be supported by harmonising the existing professional association regime, or at the very least addressing privacy, defamation and discrimination risks associated with information sharing between the various professional associations.

98. The current system is predicated on the requirement that persons who carry on a financial services business, including a financial advice business, are required to hold an Australian Financial Services Licence (**AFSL**) unless an exemption applies. A key exemption applies to a person who provides financial services as an authorised representative of an AFSL holder. Individual financial advisers typically provide financial advice as authorised representatives of a corporate AFSL holder. AFSL holders are generally responsible for the conduct of their representatives.[61]

99. While ASIC considers and approves applications for AFSLs, it does not similarly approve the appointment of authorised representatives. In order to obtain an AFSL, an applicant must demonstrate to ASIC a number of things, including that it is competent to carry on a financial advice business, has adequate risk management systems in place and can meet its other obligations as a licensee. There is no analogous central or standardised process for the appointment of authorised representatives, so that the process and requirements can vary between and even within each licensee.

100. The introduction of FASEA has been a significant development. Westpac believes it is desirable to expand the scope of FASEA's responsibilities, so that FASEA becomes responsible for matters such as: entry into, and removal from, the profession; issuance of practising certificates; continuing professional development; and the setting of professional standards for individual licensees. FASEA could be given statutory powers to deal with breaches of ethics including by imposing conditions on advisers' authorities to practise. The proposed code of ethics, on which FASEA is currently consulting, could be expanded to include a registration system within the same framework. Breaches of conditions could, as with the proposed FASEA code of ethics, give rise to sanctions and potential civil liabilities.

101. Moving to an individual registration model in that way would enable FASEA and ASIC to have greater power over authorisations, including considering matters such as competency and risk management. It would also result in financial advisers having and taking greater responsibility and accountability for matters such as training, education and conduct.

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[61] See sections 917A-917F Corporations Act.

102. An individual registration model has well-known precedents in other professions, both in Australia and abroad. For example, the Law Institutes and Law Societies of the various States and Territories have regulatory functions under the applicable legislation, including a registration function through the issuance of practising certificates. They also have input into the professional rules that regulate conduct. In the United States, firms wishing to act as broker-dealers are required to join a self-regulatory organisation. The Financial Industry Regulatory Authority (**FINRA**) is the largest of these organisations, and carries out various functions including licensing and accrediting staff at broker-dealer firms, monitoring compliance with US Securities and Exchange Commission (**SEC**) rules and reporting suspected breaches of rules to SEC. FINRA is subject to SEC oversight, which can take action against FINRA and other self-regulatory organisations that fail to fulfil their regulatory responsibilities.

103. Reforming the regulatory model in this way would place financial advisers in a position similar to that of other professionals, by making them solely personally responsible for the advice they provide irrespective of the business model under which they operate. While that would not preclude advisers from being employed by a corporate licensee or acting as its authorised representative (a requirement that would be retained), it would strengthen personal accountability for the provision of personal advice and services to clients, and provide greater powers and flexibility to respond to instances of improper conduct by individual advisers. An appropriate separation of individual adviser and licensee obligations could remove any disincentive that may exist for some licensees to report adviser misconduct and facilitate a more collaborative engagement model[62]. It would likely also encourage reporting to any professional bodies with disciplinary powers

104. Moving to an individual registration model would have a range of implications for ASIC that would need to be addressed. As noted in Mr Kell's evidence, there are currently around 25,000 financial advisers and around 6,000 AFSLs in Australia. While that has, in the past, been considered an impediment to moving to an individual registration model, those types of numbers have not prevented other professions from operating in that way. Westpac would suggest that a shift to individual registration coincide with the introduction of a Fidelity Fund for advisers, similar to those which exist for the legal profession and which are administered by the various Law Institutes and Law Societies, and with the introduction of a minimum capital requirement relative to the adviser's funds under administration or client base as a pre-condition to granting such registration.

Question 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 excising system of licensing only at the entity level? T1986.5-9

105. There is no reason why the system for the professional discipline of financial advisers could not be managed through a single body. There is an opportunity for the regulation of professional discipline to be eventually consolidated within FASEA. This would require legislative amendments to extend FASEA's powers. If that were to occur, it would make sense for the registration of individual financial

[62] T1905.19-28; T-1918.5-20.

advisers (separate to the licensing of financial services entities by ASIC) also to be handled by FASEA.

Questions 25: 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? T1986.11-13.

Questions 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 the regulatory culture might assist in reducing the incidence of misconduct in the financial advice industry? T1986.13-16

106. It is convenient to address Questions 25 and 26 together.

107. In the past decade, there have been significant changes in the regulation of the financial advice industry, in particular through the FoFA reforms. ASIC, as the primary regulator in this area, has had a significant amount of work to do in guiding licensees, gatekeepers or other intermediaries and other participants in the advice industry as these measures were developed and implemented as well as in actively regulating the financial advice industry, ascertaining areas in need of further attention, and balancing its work in relation to that industry with its numerous other responsibilities.

108. Westpac would welcome a modification in the regulatory approach so as to also place significant emphasis on consultation and dialogue between the regulator and industry participants to foster an environment where the regulator and industry can agree on key problems and industry is then motivated to work together to find appropriate and timely solutions to regulatory and risk issues.

109. One way in which the regulatory culture could be enhanced in this way would be through the introduction of an ability for industry participants to apply to ASIC for 'private' rulings on the application of financial services laws to a particular set of facts or practices. This power would be similar to that held by the Commissioner of Taxation in relation to taxation laws. This power would enable industry participants to obtain binding advice from ASIC as to how a financial service law applies to them in particular circumstances. The value of such a process would be to promote compliance with the law by encouraging licensees to engage constructively with the regulator in respect of situations where ambiguity or complexity in the array of potentially relevant financial services laws and regulations affects a practice or product and to make adjustments as necessary. The existence of this process would allow early visibility by ASIC of how particular regulatory issues are being addressed, encourage consultation, dialogue and guidance about acceptable approaches to particular regulatory issues and provide certainty to industry participants as to the appropriateness of their processes.

CONFLICTED REMUNERATION AND WHITE LABEL PRODUCTS

Question 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? T1986.22-25

110. Some of the benefits that arise from including within one financial services organisation a broad range of businesses operating in different areas and at different levels (so-called vertical integration) have been outlined, with particular emphasis on platform businesses, in response to Question 4 above.

111. Any conflicts of interest which may arise from a financial adviser being part of a broader organisation that also manufactures financial products can be appropriately managed through a number of controls. With the appropriate controls in place, there is no reason why an organisation cannot and should not be allowed to own both product manufacturing businesses and financial advice businesses. In that regard it should be noted that potential conflicts can and do occur outside Integrated Businesses and must be managed. A good example of a potential conflict includes an exclusive distribution arrangement.

112. The kind of controls that assist in managing the risk of conflict are outlined at paragraph 24 above which include comprehensive risk and compliance, remuneration, education and technology frameworks, as well as processes to deal with APL selection.

Question 28: Should the statutory carve-out to the ban on conflicted remuneration including the recent carve-out in relation to insurance commissions be maintained? If so, why? T1986.25-27

113. At the present time, Westpac does not consider that it is necessary to further remove or modify the existing statutory exceptions to the ban on conflicted remuneration in relation to insurance commissions.

114. Westpac does not consider that remuneration based on upfront and trailing commissions necessarily leads to poor client outcomes because of the following:

    a. appropriate compliance measures, including monitoring and auditing, will effectively ensure the provision of quality of financial product advice;

    b. enhanced and transparent disclosure of commissions; and

    c. appropriately managing the potential for the commission to motivate inappropriate advice, and client perception that it may do so, needs to take into account the complex interplay between the structure of the payment, the disclosure to the client, and the understanding of the impact of the commission on the life insurance premium.

115. The Life Insurance Framework seeks to balance the possibility that commissions may motivate inappropriate advice with the fact, as found in the Financial System Inquiry, that commissions in relation to life insurance were *"a longstanding industry practice reflecting that life insurance has*

higher arranging costs, such as managing the underwriting process, and that consumers are often not independently motivated to purchase life insurance".[63] That is, the process of recommendation and ongoing time spent in yearly reviews and potential claims is time-consuming, and commissions subsidise the fee that would otherwise have to be collected by the financial adviser from the client upfront to allow for their time. Importantly, the present commission payment methodology spreads the financial adviser cost to the client over the life of the policy – that is, the client is only required to pay the same premium every year, but the adviser is remunerated for his or her work upfront in establishing the policy.

116. The Life Insurance Framework is the culmination of a period of extensive industry consultation having been invested in achieving balance between these factors, which came into effect on 1 January 2018. The reforms were based on a thorough review chaired by former APRA member, John Trowbridge. The Corporations Act has been amended to remove the blanket exception from the ban on conflicted remuneration for commissions on life insurance products.[64] The Corporations Regulations have also been amended to prescribe when commissions are permitted. Further, ASIC has been given the power to make legislative instruments which place limits on commissions through setting acceptable ratios between commissions and the cost of the policy (that is, commission caps) and to allow commissions to be clawed back if policies are cancelled (or reduced) in their first two years.[65] ASIC has exercised this power[66] and set the commission cap at 80% of the premium in the first year of the policy from 1 January 2018, 70% from 1 January 2019 and reducing to 60% from 1 January 2020, with a maximum trailing commission of 20% of the premium in all subsequent years.

117. Westpac supports the Life Insurance Framework reforms. Westpac believes the impact of these reforms should be considered and understood before further changes are made. ASIC is monitoring the impact of the recently implemented Life Insurance Framework through regular data collection from insurers. ASIC will use this data to act promptly where consumer detriment is identified. Ultimately, ASIC will conduct a post-implementation review in 2021 to assess the impact of the reforms and advise Government on further reform if required.[67]

118. Westpac will support further reforms to life insurance remuneration should ASIC's post-implementation review conclude that the quality of life insurance advice is being adversely impacted by remuneration incentives.

119. In respect of other conflicted remuneration, Westpac also supports further consideration of the need to remove or modify the existing statutory exceptions to the ban on conflicted remuneration, particularly with respect to stamping fees received by financial advisers.

[63] Australian Government, *Financial System Inquiry Final Report* (7 December 2014) 218-219.
[64] *Corporations Amendment (Life Insurance Remuneration Arrangements) Act 2017* (Cth.).
[65] Section 963BA Corporations Act.
[66] ASIC Corporations (Life Insurance Commissions) Instrument 2017/510.
[67] ASIC, 'ASIC releases instrument setting the commission caps and clawback amounts as part of the life insurance advice reforms' (Media Release 17-168MR, 5 June 2017).