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LETTER FROM THE PRESIDENT

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Lessons for Canada – How we can learn from the dark self-reflection of Australia

Australian Royal Commission recommends tightening internal compliance practices and better regulatory oversight, not extensive new legislation and more rules

HIGHLIGHTS:

In its report the Australian Royal Commission described a massive scale of misconduct over the past five years or so.

The misconduct has occurred throughout the period since the new legislation and regulations referred to as *The Future of Financial Advice* was put in place effective 2013.

The Royal Commission has refrained from extensive new legislation and regulations, and focused on the need for better compliance procedures and oversight, contributing to a client-first culture, and tougher enforcement by the regulators.

It has taken 13 months, over 10,000 submissions, and six rounds of hearings, but several weeks ago the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry released its final report.

It made for interesting reading.

AN OVERVIEW OF THE ROYAL COMMISSION'S RECOMMENDATIONS:

The Royal Commission made just 76 recommendations with the majority in the banking, insurance and superannuation businesses. The Commission made ten direct recommendations related to the wealth management or advisory business, and another seven recommendations related to culture and governance. Many observers had anticipated much harsher and extensive remedial actions, ranging from recommendations for extensive legislative amendment and new regulations and rules, to mandated structural changes at the financial institutions operating in the financial sector – particularly given the scale of misconduct across the Australian financial sector in the past five years or so.

Instead, the Commission has refrained from the calls for extensive new legislation and regulations, and focused on the evident need for greater oversight of advisors and the quality of advice, the importance of managing conflicts in remuneration arrangements, policies and procedure to ensure financial products and services are properly aligned to client needs, better training for advisors and other professionals, and the effective systems and controls to manage operations and risks. These recommendations start with firms reviewing and improving the effectiveness of internal policies and procedures and systems related to the customer experience, the quality of advice and the effectiveness of the wealth platform, to meet the desired and intended outcomes and experience of the client. The Commission also focused on culture and governance within firms, underlining the importance of firms to build a culture and governance structure of really putting the client first, and making supervisors and senior executives accountable.

The topics of the hearings were on consumer lending practices, financial planning and the wealth industry, financial services to small and mid-sized businesses, financial services to remote communities, the client treatment by superannuation funds (Australian pension savings) and the design of life insurance and general insurance. The resulting list of wrong-doing ranged from charging fees without related services, selling complex products beyond the financial literacy capability of the consumer, insufficient advisor training and professional competency, incentive schemes tied to advisor compensation, pressure selling tactics and no proper financial controls within the firms.

The conduct of the Canadian wealth management industry stands in sharp contrast to the Australian experience, with business carried out at a much higher standard of integrity and professionalism. By

way of example, in 2017 Canadian securities regulators imposed roughly C$70 million in restitution, compensation and disgorgement, while in a comparable period, the Australian Securities and Investment Commission (ASIC) ordered compensation and remediation for investors *at nearly four times* the Canadian level, totaling C$290 million.

While the numbers are staggering, it is also shocking that, not five years earlier, reforms had already been made to the Australian wealth management industry, in the shape of *The Future of Financial Advice* legislation. Effective July 2013 the legislation imposed, among other things, a ban on certain conflicted remuneration structures, a duty for advisors to act in the best interests of their clients and place client interests above their own, an opt-in obligation requiring advisors to renew agreements to ongoing fees, an annual fee disclosure statement and increased powers for the ASIC.

The question remains, with such parameters in place, how did such flagrant contravention to existing securities rules, and weak or ignored internal compliance procedures, happen?

The Commission drew its own conclusion: "greed – the pursuit of short-term profit at the expense of the basic standard of honesty. How else is charging continuing advice fees to the dead to be explained?" The adage 'means, motive, and opportunity' may be relevant here. In addition to greed acting as a motive, the Commission recognized that poor internal oversight; regulators asleep at the wheel; and a culture focused on profit, not the welfare of the client, played a significant role.

Many observers of the Australian situation had anticipated harsh remedial actions, ranging from calls for extensive legislative amendment and new regulations and rules, to mandated structural changes at financial institutions - but the Commission refrained, recognizing that extensive rules are not always the answer to proper conduct for advisors and firms. If existing and labyrinthian rules were already in place, and not properly enforced, why double-down on more rules? The Commission states "too often, financial services entities that broke the law were not properly held to account. Misconduct will be deterred only if entities believe that misconduct will be detected, denounced and justly punished." The Commission has instead focused on the need to simplify and enforce the core rules already in place. These final recommendations of the Commission, after extensive deliberation and testimony, and the experience of the failed recent reform efforts, yield important insights for Canadian regulators, namely that extensive rulebooks are not the answer to guaranteeing the best outcome for clients of financial services.

For Canada, detailed rules are already in place in the IIROC rulebook or in the proposed CSA client-focused reforms, but careful review and streamlining of these rules is necessary. Equally important is that firms provide adequate advisor training and have the flexibility to shape internal compliance and risk systems to the particular business model of the firm, incubating a positive, client-first culture. Supervisors and senior executives in the firms are ultimately held accountable. The regulator needs to provide effective oversight of these internal policies and procedures and systems, and carry out vigorous enforcement action when circumstances warrant.

A key advantage for Canada is that a significant part of the wealth industry is under the oversight of the two self-regulatory organizations that have the judgement and expertise to evaluate the effectiveness of the firms' internal compliance procedures and systems. The provincial commissions need to consider extending the self-regulatory system in the Canadian wealth sector, in light of the Australian experience.

To read the Commission's report, please click here.

Yours sincerely,

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