Rebuilding trust: A conduct regulator's perspective

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CHECK AGAINST DELIVERY

Introduction

It is a critical time for the banking and wealth industry, and the theme for this conference – 'Rebuilding trust' – is very fitting. I can see your agenda is filled with pertinent topics, including many subjects we examined at the ASIC Annual Forum a few weeks ago.

I also know you had a very productive day yesterday. In particular, I wanted to endorse the comments made by the Australian Prudential Regulation Authority (APRA) Chairman, Wayne Byres. For those of you who missed his remarks, I commend his speech to you – particularly the important conclusions coming from APRA's recent review of remuneration practices.

And, for me, I now would like to expand on some of the points I made at the ASIC Annual Forum recently. In doing so, I want to give you a conduct regulator's perspective on the challenges, and opportunities, the banking and wealth industry faces in relation to rebuilding trust.

In doing so I'd like to speak about:

- the importance of trustworthiness as a means of rebuilding trust
- the role of finance, particularly the purpose of the banking and wealth sectors
- professionalism in finance, and its crucial role in rebuilding trust
- how the identification of the characteristics of a good financial services industry could help finance be more trusted by the community.

Trustworthiness

In the financial system, trust can be broadly classified into two categories:

- First, trust in the *infrastructure*. That is, trust in the bricks and mortar that make up the financial system. For example, we trust that the payment system will function effectively, that banks will hold safe our deposits, and so on.
- Second, trust in *people*. We need confidence that the people in banking and wealth management will keep their promises, act in our interests, live up to community expectations, and do their jobs with competence and honesty.

For there to be sufficiently high levels of trust in the financial system, we need both infrastructure and people worthy of that trust.

I have observed that there is generally – at present – high levels of trust in the infrastructure that supports our system and enables the underlying financial 'plumbing' to work. In recent years, data from the Edelman trust barometer suggests that, while we have high levels of trust in this underlying financial plumbing, financial services is still one of the least trusted industries in Australia. And since trust in the financial infrastructure appears to be sufficient, the sad conclusion must be that Australians don't look to people in finance with enough trust.

Taking a step back, when one wants to be trusted it requires one to be worthy of trust – they must be trustworthy. So, how do we become trustworthy?

According to some useful work by the CFA Institute, there are three factors that assist in being seen as trustworthy in the financial services context:

- First, *competence* – that is, having the right skills and knowledge to do the job.
- Second, *care* – that is, attention and consideration applied to:
  - doing something correctly
  - avoiding risk, damage or harm.
- Third, *ethics* – that is, doing the right thing, even when no one else is watching.[1]

We also know that trust has to be earned – it cannot magically appear or be legislated for overnight. So, to rebuild trust in finance, we need to recognise that:

- first, we must work hard to re-establish trust
- second, that this rebuilding must be done by establishing the trustworthiness of people in finance through competence, care and ethics.

I'll come back to these points later in my remarks. Before doing so I want to explore what may seem a basic question, but is one that is frequently overlooked in this era of specialisation – and that is, what is the role of finance? Particularly, what is the purpose of the banking and wealth sectors?

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[1] This is based on a framework for understanding trust by Dr Tony Tan, CFA, Head of the Standards and Advocacy Division – Asia Pacific at the CFA Institute. I am grateful to Tony for presenting this model to ASIC's senior leadership in March 2018.

The role of finance

To start with, and this is also often overlooked, we need to recognise that every cent in the financial system is 'other people's money'.

Finance is not 'just numbers on a computer screen' or just a means to receive a commission or a bonus. Nor is it just about large institutions like banks, superannuation funds or investment funds.

It always comes back to *people* – banking and wealth management, like everything in finance, is a vital component of real people's lives. And, because we are dealing with other people's money, we must never forget that financial harms can, and often are, catastrophic to real people – they can cause real human suffering.

In other words, the banking and wealth sector exists to serve everyday Australians: It is a means to an end, *not* an end in itself. And the consequence of this is that products and services in banking and wealth management always need to be anchored to the core functions they serve for society.

On this point, I am pleased to see that later today you are having a panel session about the purpose of banking and whether we have lost sight of the role it performs. If you'll indulge me, I'd like to offer my perspectives on this topic.

There are different descriptions of the role of finance, but I like to use Professor John Kay's four functions, from his book *Other people's money: The real business of finance*, to guide my thinking.

Capital allocation

The first function is capital allocation: matching those who need capital with those with excess capital. In banking and wealth management, this involves linking depositors with borrowers and helping savers find the most effective investments for their money. This fundamental purpose, particularly through deposits and retirement savings, touches virtually every single adult Australian.

Inter- and intra-generational transfers of wealth

The second function is inter- and intra-generational transfers of wealth.

Wealth management is absolutely crucial for intra-generational transfers as it provides a means for people to defer and convert their savings (that is, their deferred consumption) for other purposes at some later stage in their life – their retirement, a house purchase, even a future holiday.

Wealth management is also crucial for inter-generational transfers of wealth. Professor Kay describes this as 'stewardship': the long-term care and management of assets to allow each generation to leave behind a better world than they started with.

In both cases, effective wealth management imbibes this notion of stewardship: ongoing care for and guidance about investments for the ultimate goal of making people's lives better. Importantly, this function involves a long-term, enduring relationship of care towards consumers by those in finance.

Hedging and insuring against risk

The third purpose is hedging and insuring against risks. And by this I mean managing financial and other risks to *real people*.

By way of example, I have always thought that the most important financial product ever invented was health insurance. Put simply, this is a financial solution to the most human of risks – that is, to our health. So, the role that wealth managers perform ranges from hedging traditional financial risks – market risk, liquidity risk and so on – all the way through to managing the risks we encounter in everyday life through insurance products.

Increasingly, Australians also need to rely on the wealth management sector to manage longevity risk. A quality problem, but a problem nonetheless.

Payment system

And the final role is the payment system. For a long time now, banks have been and continue to be central to this crucial function that ensures we are paid and can purchase goods and services. A function that every single Australian relies on.

Value and benefit of the finance system

Adding all of this together, banks and wealth managers perform fundamental roles for our community. You serve real people and you have an important purpose.

Accordingly, it is vital that your products and services can be relied on by real people. This is where trust comes back into play – people must be able to trust banking and wealth management. They must trust what you say you will do.

What is also important is that real people need to perceive they are getting value, both economic and non-economic, from finance. My own personal view is that people don't perceive they are getting sufficient value and benefit from finance and addressing this is crucial to rebuilding trust.

This means that the financial industry needs to look at its broader value proposition. And what I mean by this is that they need to ensure that the service they are delivering is mindful that it relates to other people's money and that, especially in banking and wealth management, it is firmly anchored to the core functions of finance I just discussed.

Professionalism

Earlier I mentioned that in order to rebuild trust, we need to re-establish trustworthiness – that is, exhibit:

- competence
- care
- ethics.

Interestingly, the concept of 'professionalism' is similarly defined, and is constituted by:

- competence
- conscientiousness.

And since conscientiousness turns on a person's ability to care about other people and the person's ethics, I would suggest that one way of exhibiting trustworthiness – and thus rebuilding trust – is to exhibit professionalism. Accordingly, I have been suggesting that we need greater levels of professionalism in finance, including in the banking and wealth sector.

This idea also has other benefits. If you put yourself in my shoes, those of a regulator, you would ask yourself, 'Why are there so many examples of poor conduct in banking and wealth management?'. One view would be that there is insufficient professionalism.

So how do we heighten professionalism in finance? To start with, we need to recognise that it will need whole and undivided commitment across the entire financial ecosystem to address this challenge. It also starts with the recognition that industry needs to play its part in the good functioning of the financial system.

Our regulatory system was not designed as a police state, and this is deliberate. Instead, our system was designed on the premise that participants should also do their part to ensure the system operates appropriately. I think 'professionalism' is a good description of the role that is expected of participants.

One example of this is breach reporting. At its core, this requirement relies on participants identifying breaches quickly and reporting them quickly. It is a core part of our regulatory system that allows us to identify both individual breaches as well as broader themes, so that we can respond appropriately. Accordingly, adherence to the spirit of this requirement is as important, if not more so, than adherence to the letter of the obligation.

Let me be clear: Our call for greater levels of professionalism is *not* an abrogation of our important regulatory role. We stand ready to use, and enhance, all the regulatory tools available to us – including enforcement and regulatory intervention when necessary.

The point is that industry, and the people within it, need to do more to support the proper functioning of the financial system. They need to take more of a leadership role in promoting professionalism. For example, the industry itself, working with standard setting and professional bodies, could promote and perhaps even require professionalism within their sectors. They could, like a number of professional bodies, regulate and, if necessary, sanction participants for conduct that does not live up to their own professional standards or community expectations.

Ultimately, the financial industry needs to expect more of *itself* and from the people that work within it.

What good looks like

Now, I know there may be some in the audience who may be interpreting my comments about the need for more professionalism as just another lecture from a regulator.

That could not be further from the truth; I want, today, to give you some of ASIC's views on the behaviours we want to see by identifying some of the characteristics of what constitutes a good financial services industry – that is, one that is efficient, resilient and fair. And, by doing so, we can identify what the ultimate goal is.

For this purpose, ASIC has identified six key components of a good financial system that are particularly relevant to banking and wealth management.

First, that financial products do what they say they will do. Meaning that the design of products does not take advantage of asymmetric information, consumer biases or lack of knowledge about the product. This also means these providers have sufficient training and experience in relation to the product or service – this goes to their competence.

Second, that the providers of financial services prioritise the consumer's interests and put the consumer's interest before their own. You can start to hear echoes of the professionalism concept I mentioned earlier.

Third, financial providers look to do the right thing and act with integrity and fairness, not just comply with the law. They take into account community expectations and standards. They try their best to align their interests to the customer and consider the perennial issue of managing – and I mean really managing – conflicts of interests. Again, the echoes of care, conscientiousness and professionalism are becoming louder.

Fourth, mistakes and misconduct are quickly identified, reported and rectified.

This also relates to the fifth principle – that financial services providers engage openly with regulators, and cooperate with them when problems arise. Firms should be working towards a culture of disclosure and openness – not just about problems to resolve, but also about their business challenges and risks. Ultimately, the goal should be a culture of 'no surprises' between firms and regulators.[2]

Finally, the sixth principle is that financial services entities should also innovate and use technology to improve products and services to deliver better outcomes for consumers – for real people.

[2] Institute of International Finance, *Achieving effective supervision: An industry perspective*, July 2011, pp. 29–31.

Conclusion

In closing, we have been talking about the trust deficit in finance for far too long. It is time to move beyond the rhetoric to real solutions.

Right now, for a whole range of reasons, we have the attention of the community, our national leaders and the financial industry. There is a window of opportunity, right now, to:

- take proactive steps to improve professionalism
- for industry to take a leadership role in this, with a view to working towards the goal of a good financial services industry – one that is efficient, resilient and fair
- recognise that we are dealing with other people's money
- most importantly, make a difference for Australians.

So, let's get on with it.