ASIC

Australian Securities & Investments Commission

'What good looks like'

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Governance Institute of Australia – Essential Legal and Regulatory Update
(Sydney, Australia)
6 April 2017

CHECK AGAINST DELIVERY

Thank you for inviting me to speak at today's legal and regulatory update.

A key theme that I think is a very important trend (for regulators and practitioners alike) to consider is growing consumer and investor expectations of the people working in markets and in the financial services sector.

I can't put it much better than David Murray did in his recent Financial System Inquiry report, which said:

> To build confidence and trust in the financial system, firms need to take steps to create a culture that focuses on consumer interests … The [regulatory] framework needs to more effectively align the governance and corporate culture of financial firms, employees and other representatives.
>
> Note: See *Financial System Inquiry final report*, p. 195 and p. 193.

With that in mind I wanted to do something a bit different in my speech today. Rather than focus on section numbers, regulatory documents and past sins, I want to focus on where ASIC thinks particular sectors are now, what good looks like in some key areas we regulate and how we want to try to move more of the people we regulate toward that aspiration.

Make no mistake, I think this work should have a broader interest to firms beyond a basic interest in compliance. The reason is simple – a misalignment between what investors and consumers expect and what they get is potentially very expensive indeed. Consider these figures from the United Kingdom: a 2016 Financial Reporting Council (UK) report found that intangible assets (such as intellectual property, customer base and brand) now account for over 80% of total corporate value, compared to under 20% 40 years ago. Think now about potential value destruction if customers and investors believe they are not getting what they bargained for and 'vote with their feet'.

What does ASIC think good looks like?

Let me start with the question 'What does ASIC think good looks like?' Some of you may be familiar with ASIC's Corporate Plan, released in August of last year. The document is publicly available on our website and, importantly, at pages 36 and 37 sets out a high-level view of what good looks like for particular industry sectors.

In the brief time available today, I wanted to discuss these ideas and how we want to promote what we see as good in a few select market sectors – namely:

- financial advice
- deposit-takers, credit and insurance
- superannuation and managed funds
- corporations.

Time constraints will mean I can't cover all of these areas in detail, but hopefully I can give you an overview of some important issues we are concerned about. I then want to suggest how technology – in particular, regulatory technology (regtech) – might help us all achieve some of the aspirations around good conduct.

Financial advice

We think good is when financial advisers:

- act professionally, avoid conflicts of interest and treat consumers fairly
- deliver strategic financial advice that is aligned with consumer needs and preferences
- ensure that consumers are fully compensated when losses result from poor conduct.

Given all the media coverage of misconduct in the financial advice industry and the significant ASIC enforcement action in this area, it is easy to forget how far the financial advice industry has come over the last decade or so.

In our work, we regularly meet dedicated and passionate advisers who are delivering advice that already meets our vision of 'good' and delivers substantial benefits to their clients.

The industry as a whole is on a path to professionalism. The old conflicted remuneration models are being abandoned and the industry is moving towards much higher education standards. Advances in technology are creating new ways for Australian consumers to access financial advice that meets their needs and is cost effective.

Making sure that a 'cookie-cutter' approach to advice does not prevail over a client's needs and preferences should be an overriding goal of all advice providers.

ASIC is doing everything it can to help the industry on its journey. For example, a recent report we issued, on how large financial institutions oversee financial advice, provides a useful snapshot of where the sector is at present. I don't want to dwell today on the specific findings set out in the report that are looking at the past. What I do want to highlight, however, are some of the key things we identify in the report that people might address going forward. You can rest assured they will be certainly things that we are looking out for.

Note: See Report 515 *Financial advice: Review of how large institutions oversee their advisers* (REP 515).

Timely breach reporting is a key issue. ASIC is very concerned that any delay may affect breach reporting to ASIC and increase customer loss or detriment. It is fair to assume that ASIC views delays in breach reporting as a risk factor that often suggests broader and more intensive inquiries about a firm might be needed.

Proper record keeping and effective internal compliance audits of financial advice files are also necessary. A lack of robust systems in this area is likely not only to attract the regulator's attention, but also investor outrage if they can't get access to relevant data. A positive, though, is that in the near future it is not hard to imagine technology playing a much greater role in this area through better data storage and analytics. I will return to this point later.

Background checks when hiring new advisers is an area we all need to work on. Clients seem rightly incredulous when it transpires that advisers who have created problems in one firm are able to move around the industry without any apparent difficulty. ASIC thinks that the recent proposals by the Australian Bankers' Association (ABA) on reference checking are a good step forward, but I think the jury is still out on whether further reforms are needed in this area. Time will tell.

Finally, we recognise that things will go wrong from time to time. When they do, remediation and client communications are key. We have provided some specific guidance on what a good remediation process looks like – but, needless to say, in a good remediation program communication with clients should be clear about why customers are being contacted and give a sensible period for them to respond.

To help promote what is good in this sector, REP 515 contains various checklists and guidance that might assist in meeting the needs of customers better. We have also provided some specific guidance to help people who want to leverage technology to provide digital advice or robo-advice.

Deposit-takers, credit and insurance

We think good is when banking, credit, insurance and electronic payment providers:

- act professionally and treat consumers fairly
- provide good-quality products and services that are developed, marketed and managed in a way that serves customers well
- ensure that consumers are fully compensated when losses result from poor conduct.

Responsible lending remains a focus for ASIC. Although the law requires that a consumer be given a 'not unsuitable' loan, we expect that good responsible lending involves providing consumers with credit products that fit their needs. After all, whether a loan results in good consumer outcomes is a broader concept than whether the loan is 'not unsuitable' for that consumer. Good responsible lending recognises that distinction and takes the client's needs and actual financial situation into account. For instance, it is not enough to rely on a benchmark to estimate a potential borrower's living expenses and not make inquiries about their actual expenses. Where we have seen these practices, we have taken action.

Good also means having a recruitment, training and remuneration structure that is aligned to and reinforces the culture of doing the right thing and good outcomes for customers. ASIC's review of mortgage broker remuneration was released by Treasury recently. The review found that the current mortgage broker remuneration and ownership structures create conflicts of interest that may contribute to poor consumer outcomes. ASIC's review contained six proposals to improve consumer outcomes and competition in the home lending market, such as changes to the standard commission structure.

> Note: See Report 516 *Review of mortgage broker remuneration* (REP 516).

Good in insurance is about well-designed and easy-to-understand products that are marketed appropriately, explained well, and meet the customer's current and future needs. Junk products might be profitable in the short term, but pose a long-term risk to a company's reputation and the reputation of the industry more broadly.

ASIC's review into the sale of add-on insurance through car yards found very low claims ratios for add-on insurance products sold through these channels. For example, loan termination insurance, consumer credit insurance and gap insurance only paid out 4.4, 5 and 6.3 cents in claims for every dollar of premiums paid by consumers. This can be contrasted with car insurance, which pays 85 cents for every dollar of premium, and home insurance at 55 cents for every dollar. We also found that the high commissions paid to the car dealers were driving the sale of these products with very low value to consumers.

> Note: See Report 492 *A market that is failing consumers: The sale of add-on insurance through car dealers* (REP 492).

When things go wrong for the customer and they need to make a claim on insurance, insurers need to conduct themselves in a way that meets community expectations of claims handling. Good is dealing with claims in a timely manner, keeping consumers informed during the claims handling process, and treating consumers fairly and with empathy. ASIC's recent investigation into CommInsure and report on the life insurance industry have identified shortcomings in a number of areas of life insurance claims handling.

> Note: See Report 498 *Life insurance claims: An industry review* (REP 498).

Superannuation and managed funds

We think good is when funds management and superannuation providers:

- treat fund members and investors fairly
- deliver financial products and services that are transparent, fit-for-purpose, and aligned with consumer needs and preferences
- strike the right balance between innovation and risk to meet fund objectives
- ensure that investors are fully compensated when losses result from poor conduct.

Government policy and the intent of the law are clear. Transparency is important as it leads to better decision making, competition and accountability.

Good disclosure, including of fees and costs, will mean that investors have confidence in the information provided to them when making important decisions about which financial products to buy. Good disclosure also means that there is fairer competition between product providers.

In the absence of good disclosure, not only will investors be harmed (as they'll be making decisions based on inaccurate and inconsistent disclosure) but there will also be an uneven playing field for product issuers. These are the reasons why, as the regulator responsible for disclosure, we have been helping to ensure that industry complies with the law as intended. We updated our regulatory guidance and clarified the regulatory requirement for disclosure to help ensure that industry more clearly understand how fees and costs need to disclosed – including those fees and costs associated with investing indirectly, through interposed vehicles. We also clarified that costs must be disclosed using reasonable estimates when they are not known. Our additional guidance and the clarifications to the law will help ensure that disclosure of fees and costs is more accurate, consistent and therefore comparable.

> Note: See Regulatory Guide 97 *Disclosing fees and costs in PDSs and periodic statements* (RG 97).

We also recognise that good disclosure needs industry to come together to develop guidance that complements RG 97 and what the law and policy require. We are very encouraged by industry's recent efforts in this regard.

However, while good disclosure does have this potential to lead to better decision making, competition and accountability, it only works if the disclosure is accessible.

The Stronger Super reforms required certain disclosures to be made on fund websites – particularly product dashboards and the disclosure of transparency information (such as executive officer remuneration). However, in reviews of disclosure we undertook last year, we still struggled to find some of this information on websites. To effectively communicate with members and others, a trustee might need to do more than meet mandatory minimum requirements.

Further, when we think about what good looks like, there may be times when disclosure simply isn't enough. For example, we know some trustees, when they move people between employer and personal divisions of their super funds, default to treating people as smokers when they don't have any evidence that the member has this status. This can result in a significant increase in premiums. Given the low percentage of the population that smokes, we think that good looks like trustees treating members fairly by not having these sorts of defaults in the first instance.

Corporations

We think good is when Australian public companies:

- treat investors fairly, including when undertaking fundraising and change of control transactions
- are accountable to investors, by ensuring disclosure is accurate, complete and timely
- adopt sound corporate governance practices that support market integrity and good investor outcomes.

Disclosures concerning the financial position and performance of listed entities are central to the decision making of investors and underpin the fairness and efficiency of our capital markets.

In the fundraising area, common matters that regularly cause us concern include:

- inadequate disclosure of historical financial information
- improper disclosure of forecast financial information or other forward-looking statements
- failure to clearly disclose the business model of the company
- insufficient detail concerning the legal or regulatory risks to which their business may be subject
- risk information that is not sufficiently tailored or prominent for the company's circumstances
- insufficient detail around control impact of offer or related party transactions
- unclear or insufficient detail on use of funds
- failure to prominently disclose a limited or unprofitable trading history.

Where these disclosure problems occur, we do try to work constructively with companies to resolve the various issues. If we cannot resolve issues with the company, we will put a stop order on the relevant disclosure document. We always need to have regard to what investors want in terms of good disclosure.

An emerging issue in relation to risk disclosure is climate change risk. Internationally, various regulatory bodies, including the Financial Stability Board, are considering suggesting voluntary guidelines to try to improve disclosure in this area.

Of course, in Australia, climate risk disclosure it is already covered by various general disclosure obligations, including the requirements to disclose any material climate-related risks in a company's Operating and Financial Review (in their annual report) and in transaction documents. ASIC will continue to monitor international developments and engage with industry on industry-led disclosure initiatives.

Are we there yet?

In the time available, I have quickly discussed what good looks like in various sectors and where some areas of focus might be to improve investor and customer outcomes.

In my experience as a regulator, getting to what good looks like can often be elusive – especially as community expectations grow and evolve. But that doesn't mean we give up these aspirations.

So, if we are not there yet, then how will we get there? There are two short answers I want to suggest today. These are:

- we will get there faster by working together
- by leveraging off tools to make us more efficient and effective in the eyes of investors and customers.

Fintech and regtech

That leads me to the benefits and opportunities of financial technology (fintech) and regtech.

Put simply, fintech has the potential to do three things:

- reduce the cost and improve the efficiency of product and service delivery across the financial sector
- empower customers who will be able to deal directly with product and service providers
- empower businesses to deliver a better value proposition to their customer base through improved data analytics.

Regtech, in addition, has the potential to do three things:

- empower businesses to manage their compliance risks more efficiently at a lower cost
- improve confidence in risk management in businesses where liability is in question, such as correspondent banking and financial advice
- enhance our ability as regulators, through improved access to data and data analytic tools, to monitor and analyse risks. We will be able to devote more of our resources to being proactive and pre-emptive, rather than reactive.

Yet these opportunities come with risks. Greater customer and investor control and direct engagement, without appropriate understanding of the risks of the products and services they are accessing, raise the risk of investor harm. There will be new channels though which fraud may be perpetrated both within and across borders.

The increased use of technology to capture, store and analyse data increases the risks of that data being misused, and the systems used to capture and store the data being subject to cyber attacks. There are also risks that data will be stored, used and shared with others against the wishes of the consumers providing the data.

But there are steps in train to try to deal with these issues, and I have no doubt that the future of what good looks like will strongly influenced by these new technologies.

ASIC wants to support regtech, and in the coming weeks you will see a report on how we plan to just that. Watch this space.