



**ASIC**

Australian Securities & Investments Commission

---

## The Trust Deficit and Corporate Australia

*Keynote address by James Shipton, Chair,  
Australian Securities and Investments Commission*

Australian Council of Superannuation Investors Annual Conference  
(Sydney, Australia)  
17 May 2018

### ***CHECK AGAINST DELIVERY***

Ladies and gentlemen,

I have now been at ASIC for three months at a time of intense scrutiny of the financial services sector and its regulation.

Timing, as they say, is everything. And this is a fundamentally important time for corporate Australia, especially its financial sector.

So, after these three months, I thought it would be useful to talk about my observations of Australia's financial system and its regulatory structure, the challenges it faces and its future direction.

What I hope to do today is:

- present my perspectives as someone who has worked internationally in the financial services sector and as an overseas regulator and who is, essentially, new to Australia's financial system.
- Accordingly, I hope, I come to my new role with "fresh eyes".
- And without wishing to pre-empt the important work of the Royal Commission, I would also like to make some proposals aimed at addressing the challenges facing our financial services sector.

## My observations and ASIC's perspective

My first observation is that what I have concluded so far is very consistent with the observations and recommendations made by ASIC in recent times.

Moreover, many of the regulatory responses that I believe should be applied have already been, by the actions taken, or commenced, by ASIC. Particularly, ASIC's pursuit of regulatory enforcement, prosecutions and consumer compensation.

My observations are also informed by the work that ASIC has been undertaking in recent years to lift standards in the financial sector.

They also reflect my strong commitment as the Chair of ASIC to ensuring better protections and outcomes for Australian financial consumers.

However, regulation and its legislative framework is, of necessity, continually evolving. This evolution is now accelerating because of rapid changes in the financial sector domestically and globally, often catalysed by technological advances.

I will also add that ASIC's work and the focus of organisations like ACSI are complementary.

We both focus on corporate governance. This has the benefit of enhancing the long-term value of investments by our community.

My observations are also reflective of the important work of the Royal Commission. The Royal Commission has highlighted, for the community, the costs and consequences of financial services misconduct.

Misconduct that my colleagues at ASIC have been investigating and acting on for many years.

- In particular, the Royal Commission hearings have highlighted the totally unacceptable and widespread practice of charging advice fees where no advice was provided.
- We were pleased when the Royal Commission highlighted this totally unacceptable practice which ASIC exposed in 2016 via a public report.
- ASIC's own work in this area has resulted in \$220m in compensation to customers – with more to come.
- The Royal Commission hearings have also highlighted unacceptably poor levels of self-identification, transparency and disclosure by the industry in identifying, reporting and dealing with misconduct.

All this goes to the heart of a trust deficit facing the financial services sector and, more broadly, corporate Australia.

This failure of responsibility is jarring for me to observe as someone who prided himself on being a member of the finance *profession*.

I use the word *profession* very deliberately here, and it is something I will return to.

## The trust deficit

As I just mentioned, Australia's corporations, and the finance sector in particular, are suffering from a trust deficit.

And this current predicament is of the sector's own making.

And because it is largely of its own making, the sector must be held to account and must take responsibility for its repair.

As I have said before, ASIC and other regulators have a crucial role to play here too. But, ultimately, trust can only be restored if these companies work root and branch to change their ways...to rebuild their culture from deep within.

And, in addition to the regulatory and enforcement roles of ASIC, it is essential that investors and particularly organisations like ACSI that represent them, focus their efforts on also holding industry to account for malpractice, malfeasance or unacceptable harm to consumers.

In recent times, we have seen the important role that investor engagement has played in influencing corporate behaviour.

The sustained engagement and active stewardship of assets by investors will be fundamental to restoring trust, better governance and good corporate cultural in Australia.

## Culture and systemic conflicts of interest

Turning now, in particular, to culture in the financial services sector.

My concern is that many people in finance have lost sight of the ultimate purpose of the financial system; they have forgotten that this system is about managing *other people's money*.

The financial system's purpose is to serve core functions for everyday Australians. I use Professor John Kay's description of the four functions, namely:

- capital allocation,
- inter & intra generational transfers of wealth,
- hedging and insuring against risks and
- the payment system.

Instead of focussing on these functions, I worry that many financial services companies have become insular by focussing only on how they can maximise earnings.

Accordingly, the first job of the sector is to refocus on these core purposes, instead of exploiting opportunities to make money from its customers often to the consumer's considerable detriment.

This is exemplified by the proliferation of conflicts of interest in parts of the financial sector.

Conflicts of interest are a perennial challenge for business, especially in the financial sector, and they are certainly not unique to Australia; nevertheless, it is clear to me that a number of institutions have not taken the management of conflicts of interest to heart.

This is verging on a systemic issue. Indeed, it is the source of much of the misconduct ASIC has been responding to and which is being highlighted by the Royal Commission hearings.

The inappropriate sale of financial products in caryards by a commission-driven salesforce is but one example that ASIC has tackled in recent times.

And yet conflicts of interests are not new. So, what has surprised me is that:

- many Australian financial firms have turned a blind eye to the risks that conflicts pose to customer outcomes as their businesses evolved or grew;
- they didn't have a management system, a management culture, or codes that were attuned to identifying and resolving conflicts; and
- there has been reluctance, and often resistance, to addressing conflicts, especially those embedded in remuneration – even when ASIC pointed them out.

This resistance has, at times, extended to a reluctance to make good any harms caused by conflicts.

Too often, unacceptable conflicts were justified by firms on the basis that 'everyone else is doing it', even though it's the right thing to do to end them.

A business culture that is blind to conflicts of interest is a business culture that does not have the best interests of its customer in mind. Moreover, it is one that is not observing the spirit as well as the letter of the law.

And so, it is time for Australia's financial services sector to remember its purpose – and remember always that they are dealing with *other people's money*; it must focus on the outcomes it delivers to its customers.

- Accordingly, there must be a wholesale review by firms to identify, manage and, if appropriate, remove every conflict.
- Only when this is done can the journey of rebuilding trust with our communities begin.

In recent years, the Australian Parliament has banned commissions and other conflicted payments in financial advice.

This was a recognition that the best way to deal with some conflicts was not to manage or disclose them, but to *remove them altogether*.

This is an option that ASIC favours in relation to conflicted payments in advice. There can be no ambiguity in this area.

So, I would strongly suggest that all financial firms keep this in mind when considering how to deal with conflicts of interest arising from remuneration structures.

We have, for example, in our Report on mortgage broker remuneration, highlighted the desirability of removing at least some of the remuneration-related conflicts in this sector.

## The regulatory system

I spoke recently about the regulatory structure in Australia's financial markets.

I highlighted that this structure was, very deliberately, not designed as a police state.

And whilst ASIC and our fellow financial regulators sit at the heart of the regulatory structure, the system was deliberately designed to have a number of regulatory mechanisms and a range of compliance agents in addition to the regulators themselves.

This is the legislative framework in which we operate.

This structure is designed to have as the 'first line' of compliance the firms themselves.

This is not a theoretical construct, nor spin, it is the law of the land!

But sadly, as we have seen from ASIC's own work, and the work of the Royal Commission, this has not been observed by firms.

I am not one to quote legislation in speeches, but one provision is especially important here – section 912A of the Corporations Act.

This important provision states, amongst other things, that licensed firms 'must take reasonable steps to ensure that its representatives comply with financial services laws'.

This is an important provision since our regulatory structure was deliberately, and consciously, designed so that employee representatives are not licensed.

Nevertheless, too often I see a large difference with what firms consider as their statutory obligation to take 'reasonable steps' to ensure good behaviour of their representatives – especially when compared to the expectations of our regulators, legislators and the broader community.

In addition to this obligation, firms are required, by law, to provide financial services 'efficiently, honestly and fairly' and they 'must comply with financial services laws'.

Taking all these obligations together, the first line of responsibility for ensuring compliance, and the fairness of financial services provided, rests with firms themselves.

They are crucial compliance and regulatory agents in our system.

This is the law. This is how our system was designed.

And a firm's failure to live up to these obligations ultimately impacts on the effectiveness and fairness of the entire financial system.

Of course, one of the fundamental roles of regulators is to intervene when firms fail in their first line regulatory responsibilities.

This is core to our mission. It is something we apply ourselves to every day.

And let's also be held to account in regard to this – let's talk about our law enforcement outcomes in holding firms and people to account.

Since 2011, more than 800 people have been banned from providing financial services or credit – and more than 390 people have been banned from being directors.

And so far in this financial year, we have banned over 100 people from providing financial services or credit; we have disqualified more than 40 people from being directors of companies.

These bannings prevent individuals from engaging in misconduct again and thereby they are actions that protect the community.

And whilst the principal purpose of a banning is protective, bannings also have a strong punitive impact on an individual's livelihood. To this end they are an important deterrent tool.

In addition to bannings, we have obtained 19 criminal convictions so far this financial year and over 160 in the period since 2011.

We have not shied away from bringing matters to court for civil penalties either. This financial year alone we have obtained \$35.1 million in civil penalties.

And importantly for Australians, we have recovered more than \$230 million in compensation for consumers this year and over \$1.7 billion since 2011.

These are important outcomes which show that ASIC is determined to play its part in making sure our regulatory system works.

And I am personally committed to using every inch of our powers and tools to get the outcomes that the community deserves.

And whilst we have been trying to do our job, unfortunately, all too often, the firms who have failed in their first line responsibilities have made matters worse by not cooperating with us and, in some unacceptable cases, actually obstructed our work.

These firms have not just failed in their first line compliance duty, they have jeopardised the entire regulatory structure.

What's more they have endangered the financial system they are meant to support.

This cannot stand – because if firms continue to fail to step up to their responsibilities, the integrity of our regulatory structure, and our financial system, is undermined.

## Professionalism

I observed earlier that the Australian regulatory system was not constructed to license individuals performing financial services roles.

Accordingly, for this regulatory setting to achieve fair, honest and efficient outcomes, the people in finance need to refocus on building a highly professional and ethical mindset.

And for this to occur, employing firms, and the sector more broadly, need to have as their gold standard, *professionalism* – that is, to ensure the competence and conscientiousness of their employees.

The industry needs to embrace professionalism both in terms of:

- its structure – that is, with professional standard setting bodies, professional organisations and credible professional disciplinary structures; and
- in 'spirit' – that is, embedding professionalism in the *culture* of the employing organisations and in the broader sector that the entity operates in.

Let me be clear – our call for greater levels of professionalism is not an abrogation of our important regulatory role. We stand ready to deploy all the regulatory and enforcement tools available to us. Something I'll turn to shortly.

What I want to emphasise is that the industry, and the people within it, need to do more to support the proper functioning of the financial system and its regulation.

They need to take a true, real and accountable leadership role in promoting professionalism.

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

## ASIC's role

Next, I want to say a few words about ASIC's role and our strategic planning.

ASIC's crucial role in our regulatory structure, as well as its international reputation as a world class regulator, were key reasons why I joined ASIC.

As I said when I arrived back in the country, ASIC's job requires it to be strategic as well as forceful.

It must directly confront, and respond to, harms and misconduct in the financial sector.

ASIC strives to do its job in the best way possible within the legislative framework, and in the face of continual changes in the corporate landscape

And yes, we always need to be searching for ways to improve.

- Especially new ways to be agile and strategic;
- to adapt and evolve as circumstances change.

Let me give you some examples:

- **(Remediation)** In recent years, ASIC has made remediation of poor outcomes for retail customers a priority.
  - Since 2011, we have secured \$1.7 billion in compensation for consumers.
  - We see it as crucial that customers receive redress for the harm they have suffered.
- **(Data collection and publication as a regulatory tool)** In 2016, ASIC collected data on Life Insurance Claims Handling identifying that some insurers had substantially higher declined rates than others.
  - ASIC and APRA are working with the insurance sector to provide powerful information for consumers on claims outcomes, which will establish new world-leading benchmarks for transparency and, thus, accountability in insurance.
- **(Technology-enabled offending)** And as the nature of the financial system evolves through rapid technological change, the nature of the misconduct we deal with has also evolved.
  - Accordingly, we increased our focus on technology-enabled offending and, just this week charged an IT consultant with a total of 115 offences for unauthorised access to data held in a computer, insider trading, and destroying or concealing records required by ASIC.

And these are just a few of the many examples of how ASIC is responding to emerging challenges.

As I said, ASIC needs to critically evaluate its performance.

It embraced the recommendations made in the 2014 Senate Enquiry into the performance of ASIC and the ASIC Capability Review in 2016.



And we must continue to explore new ideas and new ways for us to do our work, especially via the adoption of new regulatory tools and approaches.

Let me take you through some of the new approaches we are looking to deliver:

## 1. Enforcement

First, enforcement.

We have utilised funding from our Enforcement Special Account over the last few years to fund a program focusing on the financial advice sector. We call this our ‘Wealth Management Project’ and it included a number of investigations on financial advice in large financial institutions.

Much of what we saw in the financial advice round of the Royal Commission hearings was based on the work of our Wealth Management Project.

We intend to accelerate and expand this intense program.

We are also looking at ways to build on our substantial enforcement outcomes.

- This could include making greater use of external expertise in our investigations and enforcement actions.
- This will help accelerate our response times and ensure ASIC continues to deliver strong enforcement results.

The Government has also announced it has accepted, or agreed in principle, to all of the recommendations of the Taskforce that reviewed ASIC’s Enforcement Powers.

This is good news.

These reforms include:

- Significantly stronger and clearer rules about the obligation of licensees to report breaches to ASIC honestly and in a timely manner.
- A stronger ability for ASIC to take regulatory action against senior managers or controllers of financial services businesses.
- A ‘directions power’, that will enable ASIC to direct licensees to take particular remedial actions such as consumer compensation programs.
- Stronger penalties for licensees.
  - For example, a breach of section 912A, the ‘efficiently, honestly and fairly’ obligation that I referred to earlier, currently does not incur a penalty!
  - It would under proposed reforms.

These are reforms for which ASIC has advocated for some time, and we are keen to work with Government to progress them.

At the same time, we want to ensure we have the processes and capability in place to enforce these new powers as soon as these become available.

Accordingly, I am very much looking forward to Mr Daniel Crennan QC joining the ASIC team as our second Deputy Chair. Mr Crennan will bring to ASIC valuable experience from both the legal bar and business that will further strengthen our enforcement leadership and capabilities.

## **2. Supervisory approaches**

Next, I want to talk about a regulatory tool I have a lot of experience in – supervision.

ASIC currently supervises firms it regulates through a combination of:

- risk-based surveillance that is aimed at a particular firm or transaction, for example our surveillance of the ASX; or
- through thematic reviews which consider how a particular issue or problem is addressed in a sector - for example, our review of the impact of vertical integration in financial advice.

Over the coming years, we will improve on this work by adopting new supervisory approaches.

For example, we are looking to apply a new supervisory focus on Australia's largest financial institutions and superannuation funds. This will involve more intensive, and dedicated, supervision, together with increased co-operation with our fellow regulators, especially APRA.

## **3. Encouraging the adoption of regtech solutions**

The third new approach I want to highlight today is ASIC's role in encouraging the adoption of regulatory technology solutions in the financial sector.

ASIC believes Australia can position itself as a world leader in the development, and adoption, of regtech solutions.

These solutions will be key to overcoming the significant conduct challenges facing Australia's financial industry, and have the potential to promote better consumer outcomes.

For example, just think about the potential of near real-time and augmented human judgement supervision.

We want to speed progress to this outcome.

To this end, ASIC is already engaging with the regtech and fintech sectors to promote opportunities to collaborate and share information on regtech.

And we want to build on this momentum to find further ways to collaborate and assist with the development of these new technologies.

## Conclusion

In closing:

As always, the extent that we can develop these initiatives will depend on our capability and level of resourcing. It is accordingly highly relevant that this is the first year that our funding will be sourced from *industry*.

And as the Treasurer confirmed last week, ASIC is in the process of discussing with the Government what additional support we need.

My job is to ensure that ASIC does its job and strategically responds to circumstances.

And in my current assessment of Australia's financial system, there is a real need for the new regulatory approaches that I mentioned earlier.

I expect there will be further initiatives necessary to enhance our regulatory approach for tomorrow's challenges.

And, of course, we await the recommendations that will come from the important work of the Royal Commission.

Our job at ASIC is to continually evolve and improve what we do to meet the significant challenges confronting the financial system.

We aim to do our job with the professionalism and competence we expect of industry participants.

And ultimately our aim is a fair, strong and efficient financial system for all Australians.

The industry's job is to support and reinforce this, including in their 'first line' responsibilities.

So – let's all get on with it!