ECONOMICS LEGISLATION COMMITTEE ESTIMATES:

WEDNESDAY, 4 JUNE 2014 – 09:00 to 11:35

1. **P14 (P10 in Transcript PDF) (Senate Inquiry Team)**

Senator MARK BISHOP: Would you provide on notice to the committee a copy of that licence agreement or arrangement you enter into with Commonwealth Bank, in due course when it is concluded?

Mr Kirk: Yes, and I would note that that will be a public document in any event.

Senator MARK BISHOP: If you could make it available to the committee, that would be appreciated.

Answer:

To be provided. The licence conditions are still being negotiated. The agreement in principle between the Bank and ASIC is that in addition to going back and providing the two missing steps (upfront communication and the offer of $5000 to get independent advice) the conditions will provide for

1. *Independent review of whether there were any other changes to the process steps in the original methodology to the methodology that was used beyond Project Hartnett in compensating customers of both CFPL and Financial Wisdom, beyond those two already identified; and*
2. *Independent review of the adequacy of the methodology which was used for determining advisors and clients that were within scope for the compensation process.*

2. **P17 (P13 in Transcript PDF) (Senate Inquiry Team)**

Senator MARK BISHOP: I understand that, but my question wasn't, 'What were the problems and what was the cultural focus of the bank?' My problem is that, when all of the sins have been disclosed, identified, reviewed and assessed by ASIC and correspondence sent to them identifying these 38 miscreants, they only revoke the authorisation of 12. My question is: why were the other 26 still flogging financial products? What is the answer?

Mr Kirk: The bank had not revoked their authorisations.

Senator MARK BISHOP: Thank you, I understand that.

Mr Medcraft: I might take that on notice, because on that one I would like for us to come back you.

Answer:

As set out at paragraph 14 of ASIC's Initial Submission to the Inquiry into ASIC's Performance, the purpose of ASIC's 2007 surveillance of Financial Wisdom and CFPL was not to identify and deal with individual problem advisors. Rather, it was to test the licensee's broader compliance systems and processes for monitoring and management of its advisors. The surveillance revealed the inadequacy of those systems and processes and ASIC

then sought to take steps to address that inadequacy through first the Continuous Improvement Compliance Plan (CICP) and, later, the enforceable undertaking.

This approach was adopted in light of a number of important facts.

A. *ASIC had a the time long-standing, publicly-expressed concerns with the quality of advice provided by the financial planning industry in Australia, stemming from our surveillance work, as well as our industry `shadow shops' (including in 2003 and 2006).*

B. *The concerns were not that there were some bad apple advisors or a few bad firms in the industry that needed to be removed. The concerns were that there were widespread problems with both the systems and culture across the industry that were resulting in widespread poor quality advice and that without change to those systems and culture the high level of poor quality advice would continue. ASIC chose to prioritise the use of the resources available to it to working to change systems and practices in the industry, with an initial focus on the larger players in the industry that had the greatest number of authorised representatives. The alternative, focussing more on individual planners would have removed some of the products of the system and cultural problems but not the systems and culture that produced them.*

C. *It is a primary tenet of the Corporations Act regulatory settings for financial services that licensees are responsible for the conduct of their authorised and employee representatives. It is thus essential that licensees have a system for monitoring the conduct and quality of advice provided by their representative advisors. CFPL and Financial Wisdom had such systems. Their purpose was to identify risks to the licensee which then needed to be managed by the licensee.*

D. *When conducting a surveillance focussed on considering the systems and culture of a firm, ASIC often would obtain and consider the firms register or list of advisors considered to be a risk to the firm. That was done in the CFPL Financial Wisdom surveillance. The purpose of doing so was to test the adequacy of the systems for monitoring and recording problematic advisors and the systems for addressing the risks that those advisors raised, whether through targeted training, greater monitoring and supervision or in more extreme cases breach reporting to ASIC and/or removal of authorisation. As is clear in ASIC's February 2008 letter setting out the findings of the surveillance, ASIC concluded those systems were inadequate and sought a response from the licensee on how those inadequacies would be addressed which subsequently resulted in the CICP program.*

E. *As a general matter, and more particularly in the context of the industry wide problems noted above, ASIC's approach in such matters was not one of obtaining the list of advisors that a licensee's monitoring had rated as high risk in order to conduct its own investigation and potentially take action against each of those advisors. Such an approach would involve ASIC using all of its resources doing investigations of individual planners in a firm (in the CFPL/Financial Wisdom matter potentially involving 38 investigations). It would likely be inefficient as a very broad range of conduct could lead to an advisor being rated high risk by its licensee, only some of which might warrant investigation or enforcement action. It would be targeting the symptom of the problem i.e. poor advisors when ASIC was trying to target the cause, i.e. bad systems and culture, and it would be inconsistent with the licensee being responsible for the conduct of its advisors and being required to breach report material breaches. It would also provide an incentive to licensees not to monitor or not to record and fully document information about high risk advisors.*

Consistent with this, ASIC did not conduct an investigation of each of the 38 advisors in order to determine whether Enforcement action was warranted. Nor did it investigate in

sufficient detail to determine why the licensees had removed the authorisation of some and not of others. It should be noted in this context that some of the range of conduct which would result in an advisor being classified as a critical risk in the licensees' then risk rating system would warrant removal of authorisation and breach reporting to ASIC whilst other conduct may, depending on the detailed circumstances, have been appropriately managed by other mechanisms including training, close monitoring and supervision and changes to remediation. A critical rating did not necessarily mean that inappropriate advice had been provided, but might arise from failings in the documentation of advice and compliance steps. This is consistent with the primary purpose of the risk rating system being to identify risks for the licensee.

It is relevant to note in this context that following the 2007 surveillance, one element of the CICP was to improve the licensee's breach reporting material breaches, and that subsequently breach reporting did occur and, ASIC did take enforcement action against eight CFPL advisers.

Finally, the CBA has advised us that of the 38 critical rated advisers at the time of the 2007 ASIC surveillance 29 are no longer with the business and those3 of them that remain have been subject to repeated reviews to test their subsequent compliance.

P18 (P14 in Transcript PDF) (Senate Inquiry Team)

Senator MARK BISHOP: The next question then, is: you said to a three interesting things this morning, Mr Kirk. You said that the Commonwealth Bank's processes prior to 2006-07 were pretty bad, you did your surveillance, you did your investigation, you had negotiations, you imposed conditions, they accepted them and then it got to the stage that, notwithstanding their undertakings and the trust that ASIC had given to them, new licence conditions had to be imposed. You now tell me that 26 did not have their authorisations revoked because the Commonwealth Bank chose not to. Why did not ASIC sometime in 2010, 2011 or 2012 just go in there, kick the doors down, and tell them at a minimum that those 26 you forgot to revoke, we are now telling you to revoke them? Why didn't you do that?

Mr Kirk: Again, without going back and looking at each of the individual advisers, it may well be that, whilst they were rated as critical, that within the bank system that did not justify revocation; it was something that could be managed by means other than revocation, like very close management or taking the more front-line advice and putting them in another role. We would have to go back and look at each individual one. Similarly, in terms of anything that ASIC could do, in terms of banning individuals, whether for any of them there was enough evidence of wrongdoing to ban them, I cannot tell you.

Mr Medcraft: Again, Senator, we will come back with a fuller response.

CHAIR: I will allow a couple of minutes just to wrap up. We will move to some other senators. If we have got time, will come back.

Mr Medcraft: Will take that on notice.

Answer:

Please refer to ASIC's answer to question 2.

3. **P18/19 (P14/15 in Transcript PDF) (Senate Inquiry Team)**

Senator MARK BISHOP: Mr Kirk, we have now received detailed correspondence from Commonwealth Bank—27 pages. I read it through on Monday or Tuesday, and that identifies the entire process of remediation and compensation, and it says who got what. It is clear, unless I have misunderstood that material, that it applied only to clients of Mr Nguyen and to the other fellow. My question still is: why then did it not at least extend to all the clients of those 50 advisers who had been classified as 'critical', and secondly, when the new licence conditions are being issued, why is it not applied to a much broader class of persons?

Mr Medcraft: Just to give fair response to your question, I think we should take it on notice.

Mr Kirk: It is the case. There may be some confusion—there was an initial compensation process called Project Harnett, which occurred before the enforceable undertaking. So it occurred through 2010 and into 2011, and the enforceable undertaking was entered into in November 2011. The Harnett process applied to clients of Mr Nguyen and Mr Orca. Then there was further remediation under the enforceable undertaking that was extended to a wider range of advisers within CFPL under the enforceable undertaking. In addition to that an undertaking was provided by the bank that was separate from the enforceable undertaking that was provided in October 2011. They undertook by letter that they would roll out the learnings and approaches from the enforceable undertaking within their business, as appropriate. One of the things they did roll out was that broader remediation policy, albeit reduced by the removal of the two items we have already talked about.

Senator MARK BISHOP: We will examine your response, Mr Kirk. All I can say to you—and I have no reason at all to suggest that it is not 100 per cent correct—is that the correspondence we received in response to questions we put to both the Commonwealth Bank and to ASIC arising out of Mr Medcraft's decision two Fridays ago, does not seem to me to be anywhere near as wide as you now suggest. It seems to be limited to the project Harnett and the identified people. So we will check that.

Mr Medcraft: I think what we should do is see that correspondence.

Mr Kirk: We certainly have not seen anything that the Commonwealth Bank has provided to you.

Mr Medcraft: Can we get a copy of that correspondence, and let's reconcile the two?

Senator MARK BISHOP: It is currently under the classification of 'confidential', and the committee is going to have a discussion about that in due course.

Mr Medcraft: I think it would be easier if we can see it.

Senator MARK BISHOP: But Mr Medcraft—this is really a question for the boss—why in the new licence conditions has it not been extended either to all of those 50 people and their clients, or to all clients as I identified related to the sections run by Mr Nguyen and the other fellow?

Mr Medcraft: Again, I think what we should do is come back to you. What we sought to do was, within the EU, where we identified there had not been consistent treatment, we sought to rectify what we had identified. But I will come back to you separately on that issue.

Answer:

We understand the question to be why ASIC has not extended the new licence conditions to "either all of those 50 people and their clients, or to all clients [in] the sections run by Mr Nguyen and [Mr Awkar]".

In response, we note that the license conditions now being finalised will provide for independent review of the adequacy of the methodology used for determining what advisors and clients were in scope for the remediation program in both CFPL and Financial Wisdom (see answer to Question 1 above). Further, the advisers to be included in the current licence conditions are currently being negotiated between ASIC and CBA. Please also refer to ASIC's answer to question 6, below.

4. **P23/24 (P19/20 in Transcript PDF) (Senate Inquiry Team)**

Senator WHISH-WILSON: Thank you. In relation to the earlier questions from Senator Bishop and Senator Williams, I focus on what we have been looking at with Commonwealth Bank. Can you give us a rough estimate of what sort of resources and staff you have had to throw at this issue since it has come to public and community attention?

Mr Medcraft: We will take it on notice, but I think last time we discussed it, it was roughly $1 million in resource cost. We will come back on it, but it has been substantial.

Answer:

Although we have not performed a detailed calculation of the resources that ASIC has devoted to the CFPL matter since the matter came to public and community attention, we estimate that it is in excess of $1 million.

5. **P24/25 (P20/21 in Transcript PDF) (Senate Inquiry Team)**

Senator MARK BISHOP: Mr Medcraft, I want you to take this question on notice and give me a considered response. I know you appreciate the time. I have done hundreds of inquiries in my almost 20 years in this place. I did numerous inquiries for outside organisations before coming here on issues for which they wanted independent review and advice. I have never been in an inquiry, at the end, where I did not have the most clear view of the outcome. This is the only time it has ever happened in my time in public life.

I continue to be much troubled by this inquiry, because I am unclear as to what has occurred. I have noted Mr Kirk's comments today, going back to 2007 through to 2009 and 2010, where you had to constantly readdress the same issues. I have noted your comments about the lack of trust and how the lesson you have learnt is that you need to be much tougher and more proactive, for the benefit of clients in this industry. I continue to be troubled by the responses we have received from the Commonwealth Bank and others.

I would ask you to give me a considered, thoughtful response on why the new licence conditions you are about to impose cannot impose the following conditions: firstly, why the entire file history on all the clients of advisers who worked with, under or above those two characters—Mr Nguyen and the other man—cannot be reviewed and recommendations made by an independent expert, appointed by yourself; secondly, why all clients of advisers at any time classified as high risk or critical risk, by the Commonwealth Bank or other organisations, cannot have their entire file system similarly reviewed so that at least the people who have lobbied to have this inquiry can see that public justice has been delivered.
Mr Medcraft: I will come back to you.

Answer:

In response to the first question (that is, why the entire file history of all the clients of advisers who worked with, under or above Mr Nguyen and Mr Awkar, cannot be reviewed and recommendations made by an independent expert appointed by ASIC), we make the following observations:

1. *In 2010 CFPL conducted and reported to ASIC on a review of Mr Nguyen's servicing planners and a number of other advisors who worked with or were associated with Nguyen, to ascertain whether the concerns raised in respect of Mr Nguyen extended to their conduct[1]. Arising from that review, CBA breach reported Joe Chan (a servicing planner for Mr Nguyen) on 30 September 2010 and 8 August 2011. Pursuant to an enforceable undertaking with ASIC Joe Chan removed himself from the financial planning industry for 2 years. The general remediation program was applied to the advisors involved.*

2. *Our understanding is that Mr Awkar did not have servicing planners.*

3. *We cannot impose such licence conditions for the reasons set out below.*

In response to the second question that is, why all clients of advisers at any time classified as high risk or critical risk, by the Commonwealth Bank or other organisations, cannot have their entire file systems similarly reviewed;-

ASIC has a number of tools available to require organisations to do certain things. These tools include:

1. ***Formal court action**: If ASIC were successful in criminal, administrative or civil action against CBA, such a remedy (i.e. undertaking a review of client files of advisers rated as "critical" or "high" risk) would not be available .*

2. ***Imposing licence agreements**: For ASIC to impose such license conditions, it must be for proper regulatory purposes; that there is a reason why the conditions are necessary to ensure that a licensee complies with the law or addresses past non-compliance. If ASIC imposed licence conditions on CBA which required CBA to review client files of all advisers rated as "critical" or "high" risk, CBA would (in all likelihood) appeal that decision to the AAT. The reasons that would prompt CBA to appeal to the AAT are likely to be the same reasons that:*

   - *CBA would not agree to the licence conditions;*
   - *CBA would point to in support its appeal; and*
   - *the AAT would refer to in upholding CBA's appeal.*

   These reasons include the fact that:

   - *ASIC does not have sufficient evidence – such as widespread customer complaints in respect of some or all of CBA's advisers or breach reports in respect of a significant number of CBA advisers - to suggest that such licence conditions are necessary or warranted.*

[1] A servicing planner assists the financial planner with tasks such as preparing paperwork and organising meetings.

- *the adviser rating system is a tool designed to appropriately manage risk within a business. If an adviser is rated "critical" or "high" risk, it does not automatically follow that they have given inappropriate advice and caused the customer financial loss.*

- *CBA has already implemented a compensation program (under the enforceable undertaking entered into with ASIC and under the earlier Project Hartnett) to remediate customers of CFPL[2] who were provided with inappropriate advice and suffered financial advice. To the extent that there were inconsistencies in that compliance process CBA has already agreed to license conditions to remedy those inconsistencies. Beyond that, ASIC does not have evidence, for example from widespread consumer or investor complaint that that compensation process has not been adequate.*

- *Such a widespread program of review would not be available as a remedy if ASIC were successful in civil, criminal or administrative proceedings against the bank.*

- *Finally ASIC cannot require CBA to undertake such a review under the terms of the enforceable undertaking between ASIC and CFPL. The enforceable undertaking between ASIC and CFPL was formally brought to a close on 26 November 2013; that is, the date on which ASIC accepted PwC's final report. Accordingly, ASIC cannot, under the terms of the enforceable undertaking (including clause 2.17), require CFPL to initiate such a review based only on the conduct and problems that were sought to be addressed through the EU and in the absence of new issues.*

ASIC also refers to its responses to the supplementary questions on notice arising from the Senate Inquiry hearing in April 2014.

3. ***By agreement**: An agreement to undertake such a review may take the form of:*

   - *Licence conditions imposed by agreement;*

   - *An enforceable undertaking;*

   - *A voluntary undertaking: note that under a voluntary undertaking, ASIC would not have the power (unlike with an enforceable undertaking) to apply to the court for orders (i.e. compelling CBA to undertake the review) if CBA did not comply with the voluntary undertaking);*

   - *A settlement agreement.*

   It is unlikely, however, that CBA would agree to undertake a review of all "critical" or "high" risk advisers for the reasons set out at point 2, above. It is important to remember that a party usually agrees to do certain things as an alternative to ASIC taking enforcement action against the party. While negotiated outcomes can and often do secure outcomes beyond what can be achieved through enforcement proceedings, they are subject to what can be negotiated between the parties. It is therefore unlikely that a party will offer to take action or incur costs under a negotiated agreement if those actions or costs go far beyond what a court would order (as would be the case with such a review).

[2] CBA recently informed ASIC that customers of certain Financial Wisdom advisers have also been compensated.