Dear Dr Batge

Re: Inquiry into Financial Products and Services in Australia

Key point:

The public debate is focusing on regulatory changes for financial planners eg holding financial planners to account to the level of a fiduciary – requiring that financial planners act in the best interests of the client. This would be a major step in the right direction – but by itself, these changes are insufficient to prevent disastrous losses such as we saw with Storm Financial etc. The key reason these changes are insufficient is because:-

- Corporations Law licenses Corporations – and not financial planners AND
- Because the research Chan-Serafin discussed below, demonstrates how readily corporate culture and corporate behaviour can readily over-ride ethical, moral and legal obligations of representatives such as financial planners. It is also possible that the effect that Chan-Serafin discusses has played a role in the recent consumer losses that are subject of the PJC's current inquiry.

Possible Solutions:

- Either put a much higher legal responsibility on the financial planning AFSL to take full and meaningful responsibility for the behaviour of its financial planning reps. This is in contrast where, over recent years, ASIC has often taken action against a rep (eg banning) while no action has been taken against the AFSL.
- Alternately, license financial planners rather than licensing corporations.

Discussion:

In the 4th August 2009 Australian Financial Review, I was struck by the possible connection between two articles attached, namely:-

- "Liars need others to liar too" and
- "Storm Lender on $10million buying spree".

I had been familiar with other literature that relating to corporate behavior like that in "Liars need others to liar too", and the power of corporate culture to influence behavior during my 16 years working for multinationals. However, the publication of this article on 4th August was a timely prompting the relevance of this issue to your Inquiry into Financial Services in Australia.

The relevant points in this article are:

- "28 percent … say they would act immorally – including lying or backstabbing – to keep their jobs. A further 13 per cent say they would lie or exaggerate to keep their jobs, even though their company forbids it."
- **"the sales were so lucrative for the brokers that they shrugged off ethical concerns."** This is a possible explanation for what was happening in the Bank of Queensland North Ward branch (see AFR article 4/8/09 above) and also a possible explanation for the behaviour of that part of Storm Financial who were dealing with the Bank of Queensland North Ward branch (see same AFR article 4/8/09 above).

- “brokers and staff were intimidated into doing things they knew were wrong and whistle blowers were fired after they reported their boss was taking part in suspect shady dealings.”
- “For executives at senior reaches of the firm, the flow of cash from the department’s business became personal piggy banks financing profligate corporate spending, regal lifestyles and …. Expensive overseas junkets became the order of the day”. This is a possible characterization of the principals of Storm Financial … and also the 2 owners of Bank of Queensland North Ward branch (see 4/8/09 article above) …. “Overseeing this money machine was a small group of executives who cut corners and ignored problems as they promoted the firm and built their personal empire”. Is this what happened at Storm Financial? News reports also seem to suggest that cutting went on at Bank of Queensland North Ward branch, with the 2 principals of that branch making huge amounts of money.
- “Chan-Serafin’s research into corporate lying uses the domino theory of lying to explain how the fraud was perpetuated … This is where one or a small group of powerful people tell lies repeatedly and because of their influence or bullying, those lies are spread like contagion throughout the organisation”. I think this happens in a large percentage of product sales (distribution) organizations …. And over the years I have heard comments by people who worked in these product distribution businesses, that the ‘advice’ that they were required to give was in conflict with their own personal ethics. Eg to meet their sales targets, they had to sell products to consumers where the ‘advisor’ did not believe it was in the consumer’s best interests. “ ‘Usually, in most companies that do bad things, it starts with a few individuals that lie,’ she says. If there is a business culture where there is great pressure to succeed – at all costs – then the conditions are ripe for institutional lying. ‘Very often, when these kinds of behaviours get down to lower echelons, they don’t know they are lying. They think they are giving honest answers to consumers’ says Shan Serafin.” I think this also happens a lot in product distribution in Australia – where reps with very little training (eg just a bare RG146 training but with an emphasis on sales skills) are front line fodder to sell the employer’s (or employer’s parent’s) product. These inexperienced reps have so little experience about investment markets and investment risks that they simply follow the sales pitch that they have been taught – and they often don’t understand that their advice might be dangerous. eg selling a product that is in the middle of a speculative bubble. “No matter how much attention is given to ethics policies and value statements people will continue to lie”. Again, I have seen many signs of this in the product distribution businesses in Australia. I have heard many large AFSLs protest that they put a lot of focus on ethics and values. However, it comes down to the old issue about FORM and SUBSTANCE. These product distribution business can typically show strong (FORM) focus on ethics and values, but Chan-Serafin’s research means that we should take little comfort from that … you can only judge these organizations by SUBSTANCE – what their reps actually do in practice. You have to go out and look at the advice and behaviour itself to see whether these ethics and values were put into practice. You might recall for example, that in the last super switching shadow shopping, AMP was given an enforceable undertaking because
    - “planners' files did not disclose a reasonable basis for advice;
    - failed to make proper disclosures about the costs of acquiring the recommended product and the significant consequences of replacing the existing product;

- made statements on its website and in its Financial Services Guide that suggested AMPFP Planners could consider a broader range of products than permitted, which could have misled consumers"
  - http://www.asic.gov.au/fido/fido.nsf/byheadline/06-251+ASIC+accepts+a+legally+enforceable+undertaking+from+AMP+financial+planning?openDocument
  - http://www.aph.gov.au/Senate/committee/corporations_ctte/asic/asic_07/report.pdf

Bottom line:

- If Corporations Law is structured in a manner that puts financial planners under the power of corporate executives, there will be times when at least some of those executives will drive (by carrot and stick) their financial planners to over-ride any ethical, moral and legal obligations, in the process of providing unethical or dangerous advice. In these circumstances, isn't it unfair and unreasonable that the wrath of any future regulations, be focused on punishing the offending financial planner. In the circumstances described, doesn't the executive in charge have a far higher burden of guilt. I believe this issue exposes a major design flaw in Corporations Law.

Yours Sincerely

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