

How ASIC Can Become a Feared Regulator

The revelations last week at the Banking Royal Commission illustrate the economic principle that people respond to incentives. Charlie Munger long ago summed this up with “show me the incentive and I will show you the outcome”. The rewards for ripping off customers are substantial, the probability of being caught is low and the punishment if caught is low. It’s no surprise that Australians continue to be cheated out of their hard earned wealth. The financial services regulator ASIC, looks worse as the weeks go on as more misconduct is dug up and its failure to punish misconduct with any severity becomes increasingly untenable.

The behaviour of AMP exposed by the Commission shows that it had no fear of ASIC. Clients were ripped off and processes continued to exist that directly contravened years old legislation. AMP then lied to and misled ASIC about the extent of the misconduct. AMP had a report prepared into the misconduct by a law firm which the board made changes to, before telling ASIC the report was independent. AMP’s behaviour is indicative of the attitude of some large financial services providers. They believe that ASIC either won’t find out what they are doing or won’t materially punish their misconduct so they act with impunity.

The Royal Commission will likely call ASIC to answer why it has failed to issue material punishments. The barristers may ask why ASIC hasn’t changed the way it operates when its actions clearly haven’t led to a change in behaviours at large financial services firms. The announcement that the Federal Government will increase the fines and jail sentences that apply for criminal misconduct is somewhat helpful, but it doesn’t address the cultural issues at ASIC. Enforcing these higher penalties requires a regulator to investigate the misconduct, press charges and go through the court process to obtain convictions. As it currently stands, ASIC hasn’t demonstrated it is up to the task with large financial services providers.

However, there is a much easier way for ASIC to start earning a reputation as a regulator to be feared. ASIC holds the right to grant and rescind financial services licences. It also has the right to vary the terms of licences and apply conditions to licences. ASIC has used these rights in the past, particularly where misconduct has occurred. These rights are the key to ASIC becoming a feared regulator.

Now, picture a press conference called at 9am on a weekday morning. The Chair of ASIC, James Shipton steps up to the microphones and addresses journalists with a live feed running to ABC News 24 and Sky News.

“Ladies and gentlemen, thank you for coming this morning. I’ve called this press conference to announce that we have amended the financial services licence of AMP and are beginning a process of investigating AMP to determine whether they remain fit to continue to hold a financial services licence.

No doubt you saw the questioning of AMP executives at the Banking Royal Commission last week. AMP has admitted that it illegally charged clients for services it did not provide. It has also admitted that it lied to and misled ASIC in regards to this misconduct. These actions are extraordinarily grave and merit substantial penalties which may include imprisonment for those involved. ASIC was already investigating this conduct prior to the admissions at the Royal Commission last week, but this investigation has now been broadened and accelerated.

After an initial assessment of the conduct by AMP, ASIC is no longer able to positively conclude that AMP is fit to provide financial advice to its clients. As a result, we have this morning amended AMP’s financial services licence. Our immediate focus is limiting the potential damage to its customers whilst a fulsome investigation of AMP’s operations is undertaken. We have considered the potential of cancelling AMP’s licence to provide financial advice altogether but

have determined that at this stage this would not be in the best interests of AMP's customers. The key amendments we have made to AMP's licence include:

- AMP is not allowed to engage new clients in its financial advice business*
- AMP is not allowed to hire financial advisors or to grant any new persons or groups authorised representation status on its licence*
- AMP is not allowed to advise its existing clients on new financial products or services but may continue to advise existing clients on the financial products they already own*
- AMP is not allowed to bill its clients for financial advice but may accrue the fees with the potential to charge these fees to their clients in the future*

These restrictions will remain in place until the investigation into the conduct and culture of AMP has concluded, substantial changes have been implemented and ASIC is satisfied that AMP is fit to hold a financial services licence. I must be clear that it is AMP's responsibility to prove that it is fit to hold a financial services licence. It is possible that future events could lead ASIC to conclude that AMP is not fit to hold a financial services licence for financial advice and that AMP's licence to provide financial advice could be cancelled altogether.

I also want to be clear that the actions taken today do not directly impact AMP's life insurance operations, AMP Bank or AMP Capital. These are separate business units that are not under investigation.

As part of the investigation and rectification process the following milestones will be required:

- An independent accounting firm will assist ASIC to investigate the conduct and culture of AMP. This will include a review of the advice provided to all existing and former advice clients starting from the years leading up to the global financial crisis. The accounting firm will be chosen by ASIC and will report to and be instructed by ASIC. AMP will be responsible for the cost of this review.*
- In conjunction with the first review, a criminal investigation will commence. ASIC in conjunction with state and federal police will investigate whether criminal offences have occurred. AMP's full co-operation is expected for both of these investigations.*
- AMP staff that have played a material role in the misconduct or were negligent in their duties will need to exit the business. This is likely to include board members, senior executives, line managers, client facing staff and members of the legal and compliance teams.*
- Where legally permissible, bonuses paid to those who had a role in the misconduct will need to be clawed back.*
- An independent process for providing reimbursement and damages to clients impacted by substandard financial advice will commence.*
- AMP's systems will need to be rebuilt to ensure that clients are only charged fees where it is appropriate and formally consented to.*
- AMP will need to rebuild its training and supervision functions for financial advisors. All financial advisors, whether employees or authorised representatives, will need to undergo substantial retraining.*
- A regulatory financial penalty will need to be agreed. This will be dependent upon the findings of the investigations. It is ASIC's preliminary view that a penalty of at least 50% of annual wealth management profit is required to serve as a material punishment for the misconduct and as a material deterrent to other large financial services providers.*



This list is not exhaustive and may change over time as the situation becomes clearer. This process will take months to complete. I repeat again that it is the responsibility of AMP to prove that it is fit to provide financial advice. If milestones cannot be met then the cancellation of AMP's licence to provide financial advice would be the correct response. Whilst this would be a substantial measure, it is not unprecedented for ASIC to cancel a licence where it has concluded that a business is not fit to provide financial advice.

These announcements obviously raise the question of what actions will be taken against other large financial services providers that have committed similar misconduct. At this stage, I can simply say that AMP is the first and that several other investigations are ongoing. It is our expectation that where similar circumstances apply, similar action will need to be taken.

I would like to take this opportunity to remind financial services licence holders that providing financial services is a privilege and not a right. It is ASIC's strong view that the right of Australians to receive appropriate financial services is paramount and that the business considerations of licence holders are secondary. As the regulator of financial services in Australia, we have the right and the obligation to enforce appropriate standards. The actions taken today should serve as a warning to all financial services providers.

I will now take questions."

Whilst this speech is just a figment of my imagination it wouldn't be out of place in the US or the UK. James Shipton's prior role at Harvard Law School gave him direct insight into how the US regulators use their position in these situations to punish misconduct. He only commenced his role in February and has said he is keen to improve the culture at ASIC and in Australia's financial services industry. He would certainly have the support of politicians and the general public if he did. AMP has gifted ASIC's new Chair a golden opportunity to make ASIC a feared regulator. Cometh the hour, cometh the man?

Written by Jonathan Rochford for Narrow Road Capital on April 23, 2018. Comments and criticisms are welcomed and can be sent to info@narrowroadcapital.com

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