



# “Consultation Paper 332 Promoting Access to Affordable Advice for Consumers”

Submission by the Transparency Task Force, January 18th 2021

## **Our interest in the issue of promoting access to affordable advice.**

The Transparency Task Force (TTF) is a Certified Social Enterprise based in the UK but with fast-growing international reach. As a Certified Social Enterprise we operate as a not-for-profit with a very clear mission - to promote ongoing reform of the financial sector so that it serves society better. Our vision is to become a highly respected, international and influential institution that is dedicated to help ensure that consumers around the world are treated fairly by the financial sector; and we are pleased to report that with a great deal of hard work by volunteers we are realizing our vision day by day, week by week.

We hope and believe that the primary beneficiaries of our work will be consumers; and that the sector itself will also benefit through improved market conduct and increased trust in the services it provides.

Our objective is to carry out a broad range of activities that help to drive positive, progressive and purposeful finance reform, such as:

- Building a collaborative, campaigning community; the larger it is the more influence it can have in driving the change that is needed
- Raising awareness of issues; so that society better understands the problems that exist in the financial sector and how they can be dealt with
- Engaging with people who can make change happen; because through such dialogue we can influence thinking, policy making and market conduct

Much of our focus is on rebuilding trustworthiness and confidence in financial services. To make this possible we are busy developing a framework for finance reform which we describe as a “whole system solution, for a whole-system problem” as described in [our recently published book](#); which has contributions from subject-matter experts in many countries including Australia.

We have over 2,700 members around the world who are members of our various groups; which include those interested in financial planning, investments, pensions and so on. You can see our groups [here](#). Hundreds of our members are in Australia and we are proud that several of them have become Ambassadors of the TTF, as can be seen [here](#).

For further information about the Transparency Task Force in general [see here](#) but we believe it appropriate to now briefly emphasise what we believe to be five important points:

1. We believe that we can evidence that we are a credible organisation in many ways. For example, we are the Secretariat to 2 important All-Party Parliamentary Groups in the UK; one relating to the terrible problem of [Pension Scams](#) and the other on [Personal Banking and Fairer Financial Services](#).
2. We are able to draw on a truly [international perspective](#); we are tuned into best-practice thinking around the world and we hope that may be of some value to ASIC.
3. We are a very broad church of individuals and organisations, with many perspectives and opinions but we are united in our desire to promote progressive reform and we are able to operate in a collaborative and collegiate manner to build consensus, always guided by our “North Star Question” which is “What’s best for the consumer?”
4. The rare combination of diversity and pro-consumer focus means that unlike many organisations we are tribeless; i.e. we do not simply represent the interests of one particular part of the industry with one particular commercial agenda. We are often told that this means our input into consultations is especially valued i.e. it is recognised for not just being commercially-driven lobbying; especially as the vast majority of financial regulation consultation responses around the world tend to represent industry rather than consumer interests.
5. We believe it is right, appropriate and beneficial to all if we always express our thoughts honestly and authentically. We will therefore always “say it as we see it” and inevitably that will sometimes mean we need to be critical. However we will always seek to criticise in a friendly and constructive manner. Please therefore accept that we will sometimes be a well-meaning and honourably-intentioned “critical friend” to various stakeholders, including of course ASIC, from time to time. In the interest of developing a healthy working relationship, if ever you feel the tone of our constructive criticism is sub-optimal we would be perfectly comfortable for you to let us know that - we are as happy to receive constructive criticism as we are to give it.

For all of the above reasons, your consultation on promoting access to affordable advice is a bullseye-hit on our areas of interest and we are very grateful to have the opportunity to provide input. It is crystal clear that good advice can have a very positive impact on consumer outcomes and welfare; and that there are many and complex interconnected issues that are holding back progress. Like ASIC, we are keen to improve matters and we are highly motivated to do so.

Not only do we wish to provide input by way of our written submission we would also be happy to organise involvement and input through the round table discussions that you are planning; whether they be in-person or via Zoom/a similar platform.

## **B2Q1: Questions about ASIC guidance on limited advice**

### **(a)**

1. Podcasts/videos
2. Standalone examples on different topics
3. A dedicated advice guidance ASIC web page
4. Updates to regulatory guidance
5. A limited advice checklist
6. Other - periodic interactive “round tables” via Zoom/similar with scope to ask questions and engage in discussion

### **(b) Have you read ASIC Regulatory Guide 244 Giving information, general Â advice and scaled advice (RG 244)?**

Yes; in fact one of the co-authors of this submission is intimately familiar with the contents of ASIC Regulatory Guide 244, having referenced it extensively in creating a solution to deliver scaled investment-only advice to younger, mass-affluent clients via a digital advice service. We therefore feel comfortable providing our views in respect of this regulatory guide.

### **(c) If you have read RG 244, did it help you to understand how to provide good quality limited advice? If not, how could the guidance be improved?**

Yes, it was written at a suitable level, but could be expressed in more understandable English.

We concur with ASIC’s findings in RG 244 that a significant number of Australians (a third at the time of publication in 2012) ‘are now expressing a preference for piece-by-piece advice rather than holistic or comprehensive advice’

The advice industry’s inability to address this gap in the intervening years since the release of RG 244 is suggestive of a form of “market failure”. We share relevant opinions and insights into some of the true underlying causes of this problem in your final question, and what should be done, but given that “we are where we are”, TTF believes that the development of a strong market in episodic or piece-by-piece advice is critical if the financial services industry is to genuinely service the needs of Australians of more modest financial means.

We also agree that scaled or episodic advice is best delivered when both service provider and advice recipient agree on a clearly defined scope of engagement, and where the service provider assists the advice recipient to form realistic and measurable objectives (RG 244.12).

We believe Table 2 in RG 244 (What advice providers can do to help ensure they meet their legal obligations including the best interests duty and related obligations, when giving scaled advice) is also a handy checklist that could be re-purposed in respect of the Unmet Advice Needs project.

Finally, we think it critical that Licensees and their Advisers understand the centrality of the fact that all advice is, to one degree or another, 'scaled' (RG 244.58) in that it can be 'scaled up' or 'scaled down' according to the needs of the advice recipient and the professional judgement of the service provider (and in accordance with obligations under the Best Interest Duty (Section 961(B)(2)).

**(d) Are there any specific parts of RG 244 guidance that you do not understand? If so, which parts?**

It is the view of TTF that the guidance in RG 244 is sufficiently clear and detailed so as to enable an appropriately competent and knowledgeable Responsible Manager or Representative to gain an understanding of their obligations when delivering advice that is other than 'holistic' or comprehensive.

In particular we believe that the four steps outlined in RG 244.76 (advice process for giving scaled advice) should be more broadly communicated to the advice community, so as to encourage better systematisation of the scaled advice giving process.

**(e) Is there other ASIC guidance on providing limited advice that would be useful? Please note the topics on which you think additional guidance would be useful.**

It would appear that one of the barriers to Licensees and Advisers delivering more affordable advice is some general confusion as to what types of advice could be better suited to scaled advice while meeting all the obligations contained in Div 2 Part 7.7A of the Corporations Act 2001.

In ASIC Report 627 Financial Advice: What Consumers Really Think, it was noted that the topics survey respondents were most keen on receiving advice on were Investments (45%), followed by Retirement Income Planning (37%) and Growing Superannuation (31%).

It would be worth ASIC considering if more detailed scaled advice guidance could be produced for these topics alone. This may take the form of a dedicated Regulatory Guide, or a topic/page on any website that ASIC may create as part of the Unmet Advice Needs project to promote the delivery of affordable advice.

**(f) Given the issues you have identified in response to these questions, what do you see as the potential solutions to help you in providing good quality limited advice?**

**(g) What do you see as the future challenges in relation to providing good quality limited advice? How do you think industry can best respond to and work through these challenges?**

It should be acknowledged that in a 'perfect world', high-quality affordable advice would be supplied in whatever quantity was demanded by the market. The fact that REP 627 found that 35% of survey respondents found seeking financial advice as simply too expensive suggests a form of 'market failure', the reasons for which are non-trivial.

With the benefit of hindsight, it would appear that Australia's advice industry 'optimised' over a number of decades to deliver advice to the High Net Worth market, a market that i) had a demand for complex financial advice and ii) had the means to remunerate for advice received at a level that generated an adequate risk-adjusted return for advice providers.

The changes brought about by the Future of Financial Advice regime in 2013, and further changes subsequent to the findings of the Hayne Royal Commission suggests that advice providers may revert to the relative safety of focusing on High Net Worth clients once again, in the absence of a commercially viable case for servicing clients of more modest means.

The challenge will be in finding the right settings such that personal advice can be given in a manner that is both of an appropriate standard for the recipient and economically viable for the provider.

## **B2Q2 Questions about examples in appendix to RG 244**

**(a) Are the examples of providing good quality limited advice in the Appendix to RG 244 helpful? If not, why not?**

**(b) Should the examples in the Appendix to RG 244 be expanded to include other topics? If so, which additional topics would you find helpful?**

It would appear from ASIC REP 627 that one of the topics of interest to many of the survey participants is on Budgeting and Cashflow Management (18% of respondents).

Oftentimes such advice is not considered central to many Advisers, primarily because of a focus on higher net worth pre-retirement clients, for whom budgeting and cashflow management issues may be of less relevance.

This topic is, however, of high importance to younger individuals, often where a large purchase needs to be saved for such as a first home deposit.

As a general observation, the TTF notes that the majority of the examples covered advice topics that were skewed toward retirement planning and superannuation. More guidance on 'household finance'

topics such as budgeting, and the pros and cons of directing surplus savings into different wealth vehicles (e.g. mortgage v superannuation) could be beneficial.

## **B3Q1 Questions about terminology in RG 244**

**(a) We would like your feedback on how we refer to ‘limited advice’ that is currently referred to as ‘scaled advice’ in RG 244. Do you think that any of the following terms would be a description that is easier to understand:**

- 1. Limited advice;**
- 2. Narrow-scope advice;**
- 3. Piece-by-piece advice;**
- 4. Transactional advice; or**
- 5. Episodic advice.**

We believe that ‘episodic advice’ should replace scaled advice as the preferred term by which limited advice is known.

ASIC Report 614 Financial Advice: Mind the Gap (March 2019) suggests that most Australians struggle to differentiate between general advice and personal advice (with only 19% of respondents correctly identifying personal advice scenarios).

In a similar vein, TTF believes that the term ‘limited advice’ may cause some confusion about the nature of the ‘limit’. Is it limited in quality? Is it limited in time spent on preparing it? Is it limited in liability accepted by the provider?

There is simply unnecessary ambiguity created by the use of the word ‘limited’. In the absence of detailed clarification, the making of which diminishes its reputability, advice seekers may be inclined to consider limited advice as somehow inferior advice.

Of all the remaining options, TTF considers ‘episodic’ advice as the term that both conveys the meaning of the advice objective and minimises ambiguity around it.

Most Australians would be familiar with the concept of an episode, from interactions with television shows or podcasts. The concept of an episode as a stand alone experience, with a defined beginning, middle and an end fits neatly with the nature of what may be delivered if they engage in a limited advice process.

Episodic also keeps alive the prospect of future 'episodes', and in that sense correctly describes the potential for users of episodic advice to 'dip in and out' of receiving advice as their needs dictate.

**(b) Do you have any other suggestions for terminology we could use?**

We believe that "one-off advice" and "stand-alone advice" also have merit worth considering.

## **B4Q1 Questions about ASIC guidance and examples on SOAs**

**(a) Are the model example SOAs in the Appendix of RG 244 and the current version of RG 90 helpful? If not, why?**

**(b) We are planning to review and revise our guidance in Regulatory Guide 90 *Example Statement of Advice: Scaled advice for a new client* (RG 90). What changes to RG 90 would make it more useful?**

**(c) Is there any other guidance you would like in relation to SOAs for limited advice?**

## **C2Q1 Questions about strategic advice.**

Strategic advice, often described as 'strategy-only advice', is advice that addresses a client's needs and goals either without making a financial product recommendation to the client; or by only making a recommendation about a class of financial products.

**(a) Do you currently offer strategic advice that does not make a financial product recommendation, or only makes a recommendation about a general class of financial products?**

**(b) If yes, please provide details of the strategic advice you: 1. currently provide; and 2. would like to provide in the future.**

**(c) If no, please explain why you do not currently offer this type of advice to clients. Would you like to offer this type of advice in the future? If yes, what type of advice? If not, why not?**

One of our contributors to this consultation response supplies basic facts about different strategic positions to clients so that they can make a more informed decision. Factual information on what may happen in the future (stochastic modelling) is provided in a form where clients may make an informed decision. It is carefully phrased so not to be advice.

**(e) Do you think it would be helpful to provide more examples of compliant strategic advice in our guidance? If yes, what examples would you like to see?**

### **C3Q1 Questions about digital personal advice**

**In CP 332, we define digital personal advice as the provision of automated financial product advice using algorithms and technology, without the direct involvement of a human adviser. It ranges from limited advice that is very narrow in scope to more comprehensive advice.**

**(a) Do you currently offer digital personal advice? If yes, please provide details of the digital service(s) you: 1. currently provide; and 2. would like to provide in the future?**

Among the TTF Australia community there are a number of individuals who are currently involved in ventures seeking to provide digital financial services, or who have done so in the past. These services range across the factual information, general advice and personal advice spectrum.

**(b) If you do not currently offer digital personal advice, please provide details of the digital service(s) you would like to provide in the future.**

**(c) Have you read ASIC Regulatory Guide 255 *Providing digital financial product advice to retail clients* (RG 255)?**

Yes - it's too dangerous not to read the Guidances! Among the group involved in this TTF submission, the aforementioned individuals who are currently providing, or have provided in the past, digital financial services, are familiar with the contents of RG 255 *Providing digital financial product advice to retail clients*.

**(d) If you have read the guidance in RG 255, did it help you to understand how to ensure that you provide compliant digital advice? How could the guidance be improved?**

It needed a close reading, but anything that is a Regulatory Guidance needs that. RG 255 provides a high level overview of ASIC's expectations in respect of digital advice. The guidance in respect of monitoring and testing algorithms (RG 255.73 - RG 255.75) and having an adequate 'Triage' or filtering process (RG 255.101 - RG 255.109) are also reasonably comprehensive and not too onerous.

RG 255 could be improved by ASIC seeking more insight and understanding as to how digital advice (both general and personal) is indeed created, and the many often competing priorities that are at stake in building a digital advice service, particularly for new or 'startup' entities that may not have the same level of financial resources as incumbent financial service providers.



Thus it is suggested that a market survey of digital advice providers be undertaken as part of the Unmet Advice Needs project, given that digital advice presents one avenue through which affordable advice may indeed be delivered to more Australians.

**(e) In your experience, are there barriers to providing good quality digital personal advice? Please explain your response.**

It is the estimation of the TTF submission writers with direct experience in delivering digital advice that there is, at present, a significantly different degree of difficulty between the delivery of digital general advice and the delivery of digital personal advice.

The additional requirements of personal advice, as contained in Corporations Act 2001 Section 961(B)(2), does place a large burden on the 'User Interface' (UI) to undertake the task of making sufficiently detailed enquiries (even where the advice is scoped) so as to remain compliant with the requirements of Div 2 Part 7.7A of the Corporations Act 2001.

**(f) In your experience, are there specific types of clients that are more receptive to receiving digital personal advice? If so, please explain.**

For reasons outlined in the previous answer (e) above, it has been far easier to provide digital advice to individuals who are i) more digitally savvy, ii) have simpler financial affairs and iii) are happy to constrain their interaction to only one topic (e.g. just a non-super investment plan or just a pre-retirement financial health check).

It follows from the above that younger digital advice recipients tend to be easier to service and tend to value the service higher. It should also be noted that these individuals are also the ones more likely to have insufficient financial wealth to find a suitable solution from more traditional face-to-face advice.

**(g) Have you moved any of your clients across from non-digital to digital personal advice services? if yes, what have been the challenges in transitioning these clients over to digital personal advice services?**

**(h) Are there topics of advice or specific financial products that are well suited to digital personal advice? If yes, what are they and why?**

As previously alluded to in answer to question (f) above, non-superannuation wealth creation advice (portfolio construction and execution services) have globally been the services most easily delivered via digital advice.

Parts of superannuation topics are also relatively easy to deliver via digital advice, particularly to individuals who are already existing members of a Super Fund. This is because there would already be a base of information that could be accessed by the digital advice tool in creating the advice. That said, to

date digital superannuation advice has been limited to dealing with one member (rather than a member couple), and to areas such as contribution levels and strategies and investment options and strategies. Complex retirement based strategies, particularly advice that takes into account non-superannuation assets and the circumstances of two individuals, is still in its relative infancy.

**(i) Are there topics of advice and specific financial products that are not well suited to digital advice? If yes, what are they and why not?**

Topics that are high in complexity, involve more than one individual, and include many variables, both financial and nonfinancial, are relatively more difficult to deliver via digital advice.

Such advice might include advice on the creation of a Self-Managed Superannuation Fund.

Complex estate planning advice would also be in this category, as would detailed advice involving complex holdings across multiple entities (eg SMSF, family trusts and private companies).

Where there are significant longstanding existing assets across multiple entities, the difficulty is compounded further.

As a general rule, digital advice is therefore relatively easier to deliver to individuals with lower financial complexity earlier in their financial lifecycle.

## **C4Q1 Other issues you wish to raise**

We are grateful for the opportunity to respond to this consultation as a whole; and we are particularly grateful for the opportunity to respond to this particular question. That's because it provides us with a chance to make reference to two sets of topics; those directly relevant to the consultation and those that are equally important, 'bigger picture' points that may seem somewhat tangential to it but in fact are fundamentally integral to what ASIC is trying to achieve.

We raise each of these points as separate matters; and believe that each topic raised is worthy of additional round-table discussions prior to ASIC concluding its deliberations around the provision of simplified advice to consumers. We respectfully suggest that not doing so runs the risk of ASIC "getting the right answer to the question asked; but having asked the wrong question".

### **The growing importance of the Orphan Clients issue**

There seems to be an attitude to exclude consumers with small investments as the cost of servicing them according to the regulations exceeds the fee they can charge (or the client would be willing to pay). This includes the number of clients from whom they may have collected an on-going commission in the past. The term 'orphan clients' is applied to small clients that have been cut loose from the adviser when they would be seen as being responsible for servicing with no reward. This goes to the matter of the adviser's business model of building a sustainable repeat income.

Some clients do not want to be charged an annual fee for service and hence may be reluctant to seek advice when they may feel trapped into a servicing arrangement they do not want at a price that may exceed the benefit of any annual review.

As the ecosystem evolves it is likely that we will see more services aimed at this market.

If the advice was tax deductible it may encourage clients to seek advice for smaller investment amounts with the knowledge that the gross cost would be reduced after a tax deduction.

### **The urgent need for regulatory simplification for advisers that act as a true fiduciary**

There will be industry calls for simpler legislation to enable limited, scaled or episodic advice to be delivered at a reasonable price point. The reason the legislation in Australia is so complex and difficult is because it is countering the conflicts of interest that are foundational to the wealth model in this country. There is an opportunity for the regulator to simplify the legislation *for advisers who can act as a fiduciary*. The industry can then have a choice: operate with conflicts of interest in a legislative framework that protects the consumer from those conflicts (at significant cost) or, remove conflicts of interest and operate in a simpler, cost effective legislative framework that will enable scaled advice to be delivered at a profit.

Making things as easy as possible for the retail consumer is important for the whole finance industry ecosystem, and society as a whole. Making things easy requires regulatory simplification and the wisest route to regulatory simplification is fiduciary responsibility for those providing regulated advice.

Please note that the topic of introducing a legally-enforceable fiduciary duty/duty of care/best interests duty is a matter we have previously provided extensive consultation input to, for the UK's Financial Conduct Authority (FCA), [see here](#). Interestingly, following an initial round of industry push-back, our understanding is that the FCA will be revisiting this important topic shortly.

In our view it is difficult to imagine an efficient and effective regulatory framework without a fiduciary duty for advisers being at the heart of it.

### **Regulation needs a fresh, client-centric perspective that recognises the primacy of suitability**

We need a different approach to regulating advice. Advice businesses must meet full fiduciary standards. Advice should only be for the benefit of the client and should only be paid for by the client. Advice businesses must be fully independent of product manufacturing businesses. There must be no cross subsidies. Such monies always corrupt outcomes away from what is best for the client. Regulation of advice that results in a product recommendation is the wrong place to start to fix the problem of low cost access to advice.

Regulation on top of failed regulation usually doesn't work. It simply builds complexity and opacity on top of failed rules. It forces practitioners to set their professional standard at the level set by regulation, not at the higher professional & fiduciary standard of good advice.

It is much better to have advice standards built on intended outcomes of suitable advice rather than prescriptive black letter law. Advice based on clients needs may or may not result in a product recommendation. For instance, with older clients it may focus on accessing equity in the family home to create free capital, for younger clients it may be better management of cash flows.

Typically, advice around pre & post retirement needs to take account of the more complex planning issues being dealt with compared to the issues faced by younger people. Inheritance intentions, social security entitlements, tax obligations & late life care to name a few. It's often difficult to separate issues. Holistic planning is generally required to create & maintain suitable financial plans that meet the needs of clients.

For most individuals there are at least three quite separate needs that must be recognised by the client. They are 1/ the recommendation that allows them to sleep at night. 2/ the recommendation that's most likely to meet their financial needs over time 3/ the recommendation that after a market meltdown still gives the client a lifestyle that they would prefer. In many cases the three needs do not readily align. Suitable advice is the collaborative process between client & adviser which results in clients informed consent to the plan & the risks in the plan adopted that best meets their set of trade-offs.

The skills for collaborative planning are closer to coaching & life planning rather than those needed for investment advising.

The present value of a client grows with its increasing duration. Clients stay invested when the products & services match their needs. And that seems like a pretty good idea. All participants in the service chain; clients, advisers, platforms, fund managers and even regulators are winners when advice is suitable. It is clear that ensuring suitability of advice for all must become a pre-eminent objective of the regulatory system as a whole.

Suitability must become a fundamental advice tenet for all circumstances.

There are several suitability components. First, there should be transparent disclosure of risks to enable an investor make an informed decision to take on those risks. Secondly, each investor needs to select

their preferred trade-offs between three, often competing goals a) the risks they take on that allows them to sleep at night b) the risks they need to take on to achieve their goals that have a financial dimension, & c) their capacity to cope financially when everything goes wrong.

There seems no obvious reason why this, or a very similar suitability methodology, could not be applied to affordable limited advice that is profitable to product manufacturers, distributors and still meet social obligations.

Simple financial advice at significant life events (purchase of a house, saving for school fees, appropriate insurance, building superannuation, transition to retirement, estate planning) can have a profound impact on the financial well-being of all Australians. Having a high quality episodic advice industry is a fundamental requirement for a healthy and effective wealth advice sector in this country.

### **Polycentric Governance should be actively explored and implemented**

It could be argued that the ASIC approach is based on making citizens more dependent upon regulators rather than empowering citizens to obtain the power, information, incentive and means to become co-regulators to protect and further their own interests by becoming members of non-profit stakeholder associations funded by the businesses seeking their custom. In this way regulation becomes partly privatised to improve the ability of businesses interests to become self-regulating and self-governing. Polycentric governance in its various forms should be actively explored by ASIC as a way to significantly improve the effectiveness of regulation, drive up the standards of market conduct and thereby help rebuild the trust that has been lost in the system.

There is a risk that the ASIC consultation process is counter productive in “promoting access to affordable advice for consumers” when the most informed respondents are likely to be professionals or corporations who profit from giving advice to consumers.

It could be argued that it provides evidence of the ethical blindness of regulators described in the first submission by Dr. Shann Turnbull to the Hayne Royal Commission. Refer to “Regulators poisoning corporate culture and performance”, 28 May 2018, reference number PWF.0001.0001.7989.

In addition, your process does not recognise the point made by Hayne that financial institutions have excessive power and information in relation to their customers. This must be overcome if retail customers are to be protected. A solution was presented in Turnbull’s second submission to Hayne on 21 September 2018. Ref. number: POL.0001.2000.0003. Its contents were published as ‘Causes and solutions for misconduct in financial services industry,’ Law and Financial Markets Review, 13(2-3): 99-113, 16 April, <https://doi.org/10.1080/17521440.2019.1602694>

Nor does your process answer the question raised by Hayne, as answered in Turnbull’s third submission of October 26, 2018, reference number: POL.1000.0001.0917, <https://financialservices.royalcommission.gov.au/Submissions/Documents/interim-report-submissions/>

[POL.9100.0001.0917.pdf](#). The unanswered question that Hayne raised was: “Should the existing law be administered or enforced differently?” Turnbull’s answer has also been made public in his second conference paper on: “Regulating financial misconduct: Should the existing law be administered or enforced differently?” Presented to INFINITI conference at the Adam Smith School of Business, Glasgow University, June 9-11, 2019 [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3687056](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3687056)

One way to provide affordable advice to customers is to adapt processes used by non-profit organizations. One example is the Australian Shareholders Association (ASA), which provided free advice to members, not to the public. Another example is the Citizen Utility Boards (CUBs) set up by Ralph Nader in the US over thirty years ago. These still exist today because they also serve the purpose of countering regulator capture.

The adoption of introducing non-profit customer associations as recommended to Hayne involved establishing a three-way relationship between customer associations, ASIC, and financial service providers. Instead of embedding regulators in service providers ASIC would privatize regulation by requiring service providers to fund the cost of forming customer associations. The associations would appoint a qualified advocate to protect and further their interests with each specific firm. Unlike embedded regulators, advocates could also act as mentors to management to improve competitiveness. ASIC would determine the qualifications and pay of advocates as detailed in the submissions.

The most compelling argument for ASIC privatizing regulation with a bottom-up approach is the impossibility of top-down approaches being capable of either reliably or efficiently controlling complex variables. This statement also applies to all complex businesses as stunningly revealed by Westpac.

The directors of Westpac in December 2019 set up a Review Panel with three highly intelligent, experienced and respected corporate directors with a request for them to “set out what ‘good risk governance’ looks like for an organization of the scale and nature of Westpac”. The Review Panel report of May 8, 2020 failed to answer this question.

The Review Panel supported global “group think” by stating that Westpac governance “was mainstream and fit for purpose”. However, this statement is inconsistent with: (a) Westpac incurring a record fine of \$1.3 billion; (b) the reason for the Review Panel being appointed and paid; (c) contrary the multiple shortcomings in the risk management processes that the Panel identified; and (d) Westpac failing again with its risk management after it obtained advice from its Review Panel and after its fine when APRA obtained court approved enforceable undertakings later in 2020.

Global group think by regulators and corporate directors that complexity can be managed by simple centrally controlled command and control hierarchies is not supported by system science, common sense, or by global research undertaken by Elinor Ostrom. The economics Nobel Prize committee recognized her research in 2009 on how self-regulation is achieved without markets or State. One of Ostrom’s findings is that complexity is required to govern complexity. Her research revealed the need for “polycentric governance” with numerous control centers. This is consistent with the system science

“Law of Requisite Variety” that states that, “only variety can destroy variety”. It also reflects the common sense reality that contact team sports specify teams to have equal numbers!

The concerns about ASIC’s approach to this consultation process is similarly reinforced by ASIC licensing the ASX to trade its own shares and those of all other listed corporations without disclosure of the ultimate beneficial owners and/or controllers of any shares traded. The identity of shareholders is price sensitive information that needs to be publicly available before any trade is accepted in accordance with the basic need to “know your client”.

Companies should not be described as “public” if their owners/controllers are not on the public record. It also means company directors do not know to whom they are accountable and allows intermediaries to act or decline to act to promote their own self-interests. Covert ownership is inconsistent with revealing: insider trading, tax evasion, money laundering, terrorist financing and many other criminal and undesirable activities that concern AUSTRAC.

Sunlight share trading would allow all firms to trade their own shares on any electronic platform to improve efficiency and fairness. Refer to: ‘Insider Trading: Let the sunlight shine in’, Online Opinion, November 25th, 2005 <https://www.onlineopinion.com.au/view.asp?article=3874> Also: ‘How shareholders, corporations and directors can become ethical’, The European Financial Review, August 26, 2019, pp. 28-32, <https://www.europeanfinancialreview.com/how-shareholders-corporations-and-directors-can-become-ethical/>

See:

- <https://www.westpac.com.au/content/dam/public/wbc/documents/pdf/aw/media/westpac-releases-findings-into-austrac-statement-of-claim-issues-media-release.pdf>
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### **The elephant in the room issue - the risk of Regulatory Capture**

The capture of regulators by the industries they regulate is a recognised phenomenon world-wide. It affects all regulators of all industries. This is a problem, because capture prevents a regulator from serving the public interest.

A notable recent example is the evidence of the capture of the FAA in the US by Boeing, leading to the precipitous certification of the Boeing 737 Max, which came to light in the aftermath of two catastrophic crashes.

Ultimately capture of a regulator does not serve the industry by which it has been captured either. Boeing's losses from having to stall production and sales of the 737 Max, and the liability of Boeing to airlines that had to ground their 737 Max fleet, and the damage to Boeing's reputation and sales of other Boeing aircraft, is many multiples greater than would have been the cost to Boeing of a credible certification process.

While regulators of all industries (health care, telecommunications, passenger aircraft, oil and gas etc.) are susceptible to capture, evidence from around the world indicates that regulators of the financial system are more susceptible to capture than regulators of any other industry. Financial regulators fall first, and they fall furthest.

Capture takes many forms across a spectrum. From outright bribery (as was the case in Indonesia before the Asian Crisis, and the collapse of the Indonesian banking sector) all the way to the other end of the spectrum: subtle and insidious forms of capture almost impossible to observe. For example, ideological capture. An example of ideological capture is where staff in a regulator believe that *what is good for the banks is good for the country*.

This can take place thus:

- strong, well-capitalised banks are more robust and less susceptible to collapse (TRUE);
- for banks to be strong and well capitalised they must be profitable (TRUE);
- strong, well capitalised banks tend to be bigger (TRUE);
- banks less susceptible to collapse are good for the economy (TRUE);
- what is good for the economy is good for the country (MOSTLY TRUE);
- therefore what is good for the banks is good for the country (FALSE);
- APRA, Australia's bank prudential regulator has pursued this approach for decades;
- APRA was identified by the Australian Productivity Commission as responsible for favouring big banks at the expense of small banks;
- As a result, Australia's banking sector was described by the Australian Productivity Commission in a 2019 Report as being a *cosy four-bank oligopoly* with inadequate levels of competition;
- This is why Australia, despite being a developed economy, has a banking sector which is (depending on the time period used) the most or the 2nd most profitable banking sector by ROE in the world;
- And this is why the Australian Productivity Commission has blamed the banking sector for the lack of any real wage growth in 15 years.
- There is a wealth of international scholarship, dating back to the work of Charles Francis Adams Jnr in the 1860s, on the need for a *Sunshine Commission*: an independent, credible body, at arms-length to the industry and the regulator, that would examine the performance of the regulators and expose in the public domain, instances of regulator inefficacy and capture. The



public domain is the *sunshine*, and it is only there that the power of exposure and public opprobrium is powerful enough to displace shady deals done in secret to the benefit of the industry.

- The *Guardians of Finance* by the renowned scholars James Barth, Gerard Caprio and Ross Levine (MIT Press, 2014) provides the most fulsome thesis of how such a body should be constituted, and what it should do.
- This is *not* another regulator of the industry, *nor* is it a body to protect consumers. It is an oversight authority, tasked with ensuring that the regulator is fulfilling its mission. In some ways it is analogous to a Court of Appeal, which is not simply another Court. It is rather *a sober second thought*, much like the House of Lords is to the Commons in the UK.
- We have seen an example of how this could work in Australia. The 2019 Capability Review of APRA, led by the venerated former regulator and scholar Graeme Samuel, produced a report on APRA which was an excoriation of the cultural flaws within APRA, its deficiencies in its leadership, and its failures as a regulator.
- The oversight authority proposed by the *Financial Regulator Assessment Authority Bill* currently before Federal Parliament would, in essence, make the APRA Capability Review a permanent fixture, with a permanent existence, which would conduct on a bi-annual (i.e. once every two years) basis a capability review of APRA and ASIC.
- This oversight authority will give existence to the recommendation to establish such a body contained in both the 2014 Financial System Inquiry (Murray) and the 2018/19 Banking Royal Commission (Hayne).
- An article has been written examining this development, outlining what the Assessment Authority should do and why, whether the legislation is adequate to the task and, crucially, what steps should be deployed to ensure that the Assessment Authority / oversight board does not fall victim to capture itself.
- This last point is crucial, not only because the risk exists, and if it eventuated would render the Assessment Authority / oversight board redundant, but also because of the internationally observed phenomenon: regulators (and doubtless regulators of regulators) have a life-cycle: they start off with a fire in their belly and a crusading approach, but become complacent and inattentive over time; from vim and vigour in youth they fall into torpor and senescence in old age.
- In addition, there are examples of bodies similar. For example the US GAO has a role in oversight of the efficacy of US govt departments, and reports on its findings to the US Congress. There is also a Prudential Oversight Committee that is part of the Bank of England, which looks into the efficacy of the UK PRA to determine whether it is sufficiently aware of where the next crisis may come from.

### **An overview of the rationale for a complete overhaul of the system**

The better question ASIC should be asking is for a complete overhaul of the advice/funds management system in Australia and this includes Superannuation.

The system is not working as shown by Professor Nicholas Morris who has written a book on the subject and concluded super in Australia "a policy failure" with circa 3/4 of a billion AUD being taken out from super in fees and missed opportunity. This is 3/4 of a billion AUD that could largely be back in the hands of the Australian consumer.

It may well be impossible for ASIC to properly regulate such a fundamentally flawed system. Drastic and urgent, holistic reform of the system is required. This is not a criticism of ASIC per se, rather a recognition of the harsh reality in which we find ourselves.

As part of this reform the Federal Government needs to consider establishing a Future Type Fund somewhat similar to Singapore's, to manage the vast majority of Australia's wealth and super.

The complete overhaul of the System if properly explained to people will be heavily supported by consumers. Anything less is tinkering with a broken and flawed system which will eventually be exposed and not achieve many of the things it set out to do, including helping consumers save for an acceptable living in retirement without putting excessive pressure on the Government purse.

## Concluding comments

Post-Hayne, we believe that the evolution of the financial regulatory framework in Australia is at a crossroads. It's vital we move forward in the right direction and believe that further dialogue around the specific matters raised in your consultation plus the other issues we have "put on the table" would be beneficial.

We would welcome an invitation to discuss how we may best be included in the round table discussions being planned, be that in-person or otherwise.

All queries to [andy.agathangelou@transparencytaskforce.org](mailto:andy.agathangelou@transparencytaskforce.org) in the first instance please.

Thank you.