

**Senate Standing Committee on Economics**

**ANSWERS TO QUESTIONS ON NOTICE**

**Treasury Portfolio**

Budget Estimates

4 – 6 June 2013

**Question: BET 17**

**Topic: Regulatory Guide for Financial Planners**

**Hansard Page: Tuesday 4 June 2013, Page 97-98**

**Senator CAMERON asked:**

**Senator CAMERON:** Mr Kell, I want to come back to the CBA and the Nguyen issue. Can you explain to me in as short a possible time why you have not issued a regulatory guide for financial planners instead of simply issuing enforceable undertakings on the Commonwealth Bank? Surely, this is an issue that banks, financial planners and institutions around the country should be aware of.

**Mr Kell:** Maybe I am not quite understanding the question. We have a range of regulatory guides that relate directly to standards in the financial planning industry that derive ultimately from the legislation we administer. The new future of financial advice reforms will set out a framework around conflicted remuneration, what types of conflicted remuneration are prohibited, the need to put the client's interest first, the best interest duty and other requirements about providing appropriate advice and about belonging to an alternative resolution scheme, having professional indemnity insurance, having appropriate training and qualifications. In most of those areas, we have regulatory guides that set out how we are going to apply those requirements in the financial planning area more directly. In any case where we take enforcement action, as we did in relation to Commonwealth Financial Planning, we will often reference the sorts of standards that we have set out in those guides.

**Senator CAMERON:** Did you do that in the Commonwealth Bank/Nguyen situation?

**Mr Kell:** It was evident to us that the standards there were considerably below what was required, which is why we obtained a court enforceable undertaking and banned seven different advisers from the industry and obtained compensation for several hundred clients. One of the things that we seek to do in any of these sorts of matters is to as far as possible publicise what we have done and send a message to the rest of the industry to convey that there are serious consequences. In this instance, for example, the entire leadership of that organisation changed as a result. That sent a message to the rest of the industry as well as to consumers.

**Senator CAMERON:** Mr Kell, you do not seem to take a breath when you are answering a question, and it really is quite annoying, I must say. You can answer these questions much more quickly. I am not telling you how to answer the questions. But I watched your responses to Senator Williams. Please do not do that to me. This is a very serious issue for ASIC. It is a serious issue for the government. All of the senators are concerned about it. Do not take me on a waltz around the merry-go-round.

**Mr Kell:** Trying to explain the regulation of the financial planning industry—which you have asked for—and the regulatory guides in shorthand is very hard.

**Senator CAMERON:** Take that on notice, then. Could you also take on notice whether you need to change the regulator guide for financial planners as a result of the Nguyen case. Could you also advise me—and maybe you can do so now, but if you cannot you can take it on notice—whether the regulatory guide for financial planners was in place when Mr Nguyen perpetrated these breaches.

**Mr Kell:** Do you want me to take that on notice?

**Senator CAMERON:** If you can say yes or now, that would be easier.

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**Mr Kell:** There was and is an extensive legal infrastructure in place when Mr Nguyen and the other Commonwealth Financial Planning representatives we took action against engaged in that conduct. That was the basis upon which we took our enforcement action.

**Senator CAMERON:** What is am asking is whether a regulatory guide was in place?

**Mr Kell:** There were various regulatory guides that went to a whole range of issues.

**Senator CAMERON:** Okay. Take this one on notice: if the regulatory guides were in place, can you advise why those regulatory guides failed in the case of CBA and Nguyen? ASIC was advised of the problems in the CBA on 30 October 2008 and Mr Nguyen resigned on 6 July 2009. Do you have any estimate of the financial losses to clients of Mr Nguyen through that period?

**Senator WILLIAMS:** Good question.

**Mr Kell:** I do not have an estimate of that.

**Senator CAMERON:** Could you take that on notice and advise the Senate of the losses that took place between when you were advised in October 2008 and when Mr Nguyen finally resigned on 6 July 2009. That is an important issue for the Senate. Could you also advice on notice what the problems were with the CBA procedures when in 2008 Mr Nguyen was investigated by CBA. What were the weaknesses in the CBA procedures in that investigation and why after that investigation did the Commonwealth Bank promote him on 15 October 2008 to senior planner, even after those issues had been raised? I cannot understand why that would happen. If there is a reason why it happened, the regulator is entitled to know and you should advise us as to why that weakness is in the Commonwealth Bank's processes. Could you also advise us why Mr Nguyen was allowed to resign on 6 July, citing illness, when it was clear that that was not the case. What are the implications if financial planners can resign on the basis of illness when they have been engaged in illegal activities and can then walk away to another financial planning agency? What checks and balances can you use to ensure banks and financial organisations put in place to stop this happening in the future? Take that on notice.

Could you also take on notice why you are saying that you have done—in the colloquial; it is not what you said, but this is what you basically indicate to Senator Williams—a good job and that you have resolved this issue. Why, then, do you see simply returning some financial losses to individuals as you doing a good job when they suffered humiliation and depression? One client had a stent put in his heart and had cirrhosis? There are these other areas of loss to individuals. Is it simply that your position? Is the legislation limited to financial recompense, with there being nothing for pain and suffering? Take that on notice and advise us if that is a weakness in the legislative process that the government should take a look at. Is it appropriate for the Commonwealth Bank or any agency, when they know that their officer has acted illegally, to first of all offer a pittance to resolve the losses of the individuals and then progressively up the offer and put these individuals through more stress? Why is that a culture or a process in financial organisations and what can ASIC to do to resolve that? You can take that on notice.

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**Answer:**

**Explain the Regulation of the Financial Planning Industry and the Regulatory Guides.**

***The regulation of the financial planning industry***

The regulation of the financial planning industry is underpinned by the financial services regulatory (FSR) regime in Chapter 7 of the Corporations Act. The FSR regime is principles-based rather than prescriptive about how compliance is achieved. It places very significant responsibility on Australian Financial Services licensees (licensees) for the conduct of their representatives and for ensuring compliance with the law by their representatives.

ASIC's role is to oversee and enforce compliance with the law. ASIC takes a risk-based approach to this task. The structure and requirements of the regime are summarised in ASIC's regulatory guidance which are listed below.

***ASIC's regulatory guides***

One of the tools ASIC uses to perform its role is issuing guidance to the market.

Through our regulatory guides we:

- Explain when and how ASIC will exercise specific powers under the Corporations Act (or other relevant legislation);
- Explain how ASIC interprets the law;
- Describe the principles underlying ASIC's approach; and
- Give practical guidance to industry.

ASIC's regulatory guides do not have the force of the law.

In the context of the financial planning industry, ASIC has issued a number of regulatory guides including:

- RG 36 Licensing: Financial product advice and dealing;
- RG 146 Licensing: Training of financial product advisers;
- RG 165 Licensing: Internal and external dispute resolution;
- RG 175 Licensing: Financial product advisers – conduct and disclosure;
- RG 244 Giving information, general advice and scaled advice; and
- RG 246 Conflicted remuneration.

Prior to issuing guidance, ASIC consults extensively with industry.

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**Do we need to change the regulatory guidance for financial planners as a result of the Nguyen case? Why did regulatory guidance fail in case of CBA and Nguyen?**

The regulatory guidance did not fail in the case of Commonwealth Bank of Australia (CBA) and Don Nguyen (Mr Nguyen); rather, CBA failed to properly comply with the law and follow the regulatory guidance.

**Do we have an estimate of the losses suffered by clients from October 2008 until Nguyen's resignation on 6 July 2009?**

ASIC does not have an estimate of the losses suffered by clients between October 2008 and 6 July 2009.

The fact that ASIC confronted Commonwealth Financial Planning Limited (CFPL) about Mr Nguyen's conduct on 4 December 2008 and got an assurance that Mr Nguyen was then being closely supervised and all of his advice pre-vetted before being provided to clients is a likely limiting factor on inappropriate advice generating losses during this period (see paragraph 28 of ASIC's initial submission to the Senate inquiry: *Initial submission by ASIC on Commonwealth Financial Planning Limited and related matters*).

Beyond this, the overarching aim of the ASIC-approved CFPL compensation scheme was to restore clients to the financial position they would have been in had the inappropriate elements of the advice not occurred and they had been provided with appropriate advice. ASIC required that that compensation measure be applied irrespective of when the inappropriate advice was provided.

A total of \$23,000,000 has been paid to former clients of Mr Nguyen. Of 201 such cases, five remain open with one of those presently before the Financial Ombudsman Service (FOS).

**What were problems with CBA procedures in the CBA investigation of Nguyen in 2008 and why was Nguyen promoted to senior planner in October 2008?**

Please refer to paragraphs 28-41 and paragraph 53 of ASIC's initial submission to the Senate inquiry: *Initial submission by ASIC on Commonwealth Financial Planning Limited and related matters*.

**Why was Nguyen allowed to resign on 6 July citing illness?**

The issue of employment is a matter between the employer and the employee. In our experience it is not uncommon for an adviser who is under increased monitoring and supervision from their employer to resign.

**What are implications of allowing planners to resign on the basis of illness when they have been engaged in illegal activities and can walk away to another financial planning agency?**

From a liability perspective, there are no implications associated with a financial planner resigning because the licensee remains liable for the advice provided during the financial planner's employment at the licensee. Furthermore, ASIC's ability to take action against either a licensee or a representative, where it is in the public interest to do so, does not cease because a financial planner has resigned. In the CFPL matter, the compensation regime was not impacted by Mr Nguyen's resignation.

From a practical perspective, there is a concern in a bad apple (i.e a planner who provides inappropriate advice to clients) resigning rather than having the planner's employment terminated. The concern is that the bad apple may be able to move to a new licensee more easily if the stated

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reason for their departure from their old licensee is 'resignation' rather than 'termination'. The risk is that the bad apple continues to provide poor advice at the new licensee. In the specific case of Mr Nguyen, this was not a risk because ASIC took public banning action.

#### **What checks and balances can we use to stop this happening in the future?**

In order to stop bad apples (i.e advisers who provide inappropriate advice to clients) continuing to work in the financial advice industry, consideration could be given to both mandated reference checking and the creation of a register of employee representatives. We will provide more information on these law reform proposals in our main submission to the Senate inquiry into the performance of ASIC.

#### **Why do we say we have done a good job and have resolved this issue?**

CFPL was a large and complex matter. It involved a significant amount of background work prior to the achievement of any public outcomes and required ASIC staff to make a number of judgments about the right regulatory approach to the problems at CFPL.

Overall, ASIC considers the outcomes achieved in relation to CFPL to be positive. It resulted in compensation exceeding \$50 million being paid, bannings of a number of advisers and wholesale change in the manner and culture in which advice is provided by CFPL. However, with the benefit of hindsight there are certainly lessons we have learned. ASIC's initial submission to the Senate inquiry sets out ASIC's views on both the strengths and the weaknesses of its handling of the CFPL matter – see paragraphs 48-85 *Initial submission by ASIC on Commonwealth Financial Planning Limited and related matters*.

#### **Do we see returning financial losses to clients as doing a good job? Is the legislation limited to financial recompenses with nothing for pain and suffering? Is there a weakness in the legislative process that the government should look at?**

In overseeing the financial services industry ASIC seeks to achieve a number of outcomes including securing compliance with the Corporations Act and other financial services laws and, where appropriate:

- protecting the public by taking licensing and banning action; and
- seeking compensation on behalf of clients who have suffered financial loss.

The Corporations Act requires that licensees have internal and external dispute resolution processes to address breaches of the Corporations Act. The Corporations Act does not specifically address compensation for pain and suffering. Damages or compensation may be awarded for breaches of specific provisions of the Act. The damages or compensation can be characterised as a payment for economic loss and do not incorporate a component for pain and suffering.

Damages may be awarded under the general law with respect to tortious claims for corporate negligence and/or misrepresentation. Damages for torts have two components, economic loss and non-economic loss and aim to restore the injured person to the position they were in before the tort was committed. The non-economic loss may include a contribution for 'pain and suffering.' Damages for pain and suffering are not easily quantifiable and will usually be calculated having regards to the individual's circumstances and expert opinion. In the financial services context, damages for pain and suffering would not be common. ASIC does not have the standing to pursue tortious claims for individuals.

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Regulatory Guide 139 sets out ASIC's policy on external dispute resolution (EDR). A scheme must, as a minimum, compensate a complainant for any direct loss or damage caused by a breach of any obligation owed in relation to the provision of a financial or credit product or service and for non-financial loss where appropriate.

Both FOS and the Credit Ombudsman Service (COSL) have some ability to compensate an individual for a non-financial loss in limited circumstances. In the case of FOS, the maximum amount of non-financial loss is \$3,000 per claim (see 9.3 of FOS Terms of Reference). COSL may award compensation for non-financial loss such as personal inconvenience, stress and/or anxiety. This form of compensation is only awarded in limited circumstances and generally would not be for a substantial amount (see Rule 55.15 and COSL position statement 3).

ASIC considers that whether the legislative regime should be amended to provide for compensation of affected clients for their pain and suffering is a policy matter for Government and may need to be considered in the context of compensation available for breach of statutory provisions in other fields.

**Is it appropriate for the CBA when they know their officer has acted illegally to offer a pittance to resolve losses and then progressively up the offer and put these individuals through more stress? Why is that a culture or a process in financial organisations and what can ASIC do to resolve that?**

The initial amount of compensation that CFPL offered to some clients was inadequate. For that reason, in its handling of the matter, ASIC acted to ensure that a better compensation process was put in place and that all earlier compensation offers were re-opened and reconsidered under that improved process. That resulted in increased compensation being paid in some matters. For further information, please see ASIC's response to question 227.

In terms of the broader cultural aspect, it is a fact of commercial life that in all commercial negotiations parties seek to advance their own interests and to limit costs and losses. That is in no way particular to the financial services industry. It is for that reason that providing recourse to an independent third party - in this case, FOS - is important.

Please also see paragraphs 54-62 of ASIC's initial submission to the Senate inquiry: *Initial submission by ASIC on Commonwealth Financial Planning Limited and related matters*.