

Summary of articles relating to the Royal Commission

This agenda paper contains a summary of issues raised during the Royal Commission public hearings on financial advice as reported in the financial press (primarily the AFR).

The issues include:

- Fee for no service
- Commissions
- Independence Issues
- Regulatory Issues
- Misconduct
- Fallout, repair and reforms

The paper documents developments reported in the financial press that occurred up until 21 May 2018.

Fee For No Service

There has been a large volume of reporting on the Big 4 banks, plus AMP, charging fees for services that were never actually provided to customers. This is captured under the term, 'fee for no service,' and, whilst all five banks have been found to have charged these fees, AMP and CBA have been the focus of the Royal Commission so far.

On 17 April 2018, it was reported by the Australian Financial Review (AFR) that \$216 million in fees has so far been refunded to customers, including interest, with CBA making up \$118 million (55%), ANZ \$47 million (22%), NAB \$41.3 million (19%), AMP \$4.7 million (4%), and Westpac \$3.2 million with an additional \$24 million in provisions (a total of 12.6%).

Peter Kell, deputy chairperson of ASIC, was quoted by AFR as telling the Royal Commission, "the systems that underpinned the ability to collect revenue are significantly more developed than the systems that ensured that the client received the advice."

The AFR reported several issues associated with AMP in respect to fee for no service, including conflicting allegations of interference in an independent report authored by Clayton Utz and submitted to ASIC on the topic fee for no service.

AMP had a policy, known internally as "ringfencing," or the "90-day rule," which charged customers fees without providing any service for up to 90 days after a customer left either AMP or an affiliated advisor. This policy continued despite internal legal advice that it was illegal, and included instances where affiliated financial planners sold their business and AMP continued charging fees to their customers. Another incident that was reported by AFR included an advisor who was fired from the AMP network, and their clients were subsequently charged fees by AMP, despite no service being delivered.

On 19 April 2018, the AFR reported that CBA told the Royal Commission they have so far refunded \$118 million in fees for no service (including interest), but insisted that these fees were charged because of "hopeless" information systems that were unable to monitor whether services had actually been provided to customers rather than any deliberate decision to charge these fees for no service. In some instances, CBA was charging fees to customers for up to a decade without providing services, including to some who were deceased.

There is little coverage thus far on the basis or implications of the fee for no service scandal for NAB, ANZ and Westpac.

Commissions

Specific forms of commissions for financial planners, including on insurance policies and for specific types of financial advice, were outlawed under the Future of Financial Advice (FoFA) reforms. AMP, CBA, NAB and Westpac have all admitted to paying or receiving these outlawed commissions.

Bernie Ripoll, the chair of the parliamentary inquiry that led to the FoFA reforms in 2012, was reported by AFR on 1 May 2018 as being “shocked” by the misconduct, quoting AMP and CBA as both lobbying in 2012 for better vertical integration of financial product manufacturing and sales.

On 17 April 2018, it was reported by AFR that AMP had admitted to the Royal Commission that they had paid and received commissions which were prohibited under FoFA. It was also reported that AMP incentivised commissions-based sales, as their Buyer of Last Resort system pays AMP advisors four times the book value of any AMP-listed commissions-based earning, compared to only the book value of fee-for-service revenue.

It has been reported that ANZ aggressively acquired financial advice firms in the lead-up to the introduction of FoFA, sometimes without any due diligence, in order to maximise grandfathered commissions-based income (AFR, 21-22 April 2018). In one case, ANZ offered an advisor 30% of any new commissions-based revenue generated before July 1, 2013 – the date that FoFA became mandatory. This same advisor was subsequently the subject of a complaint regarding fee for no services for a period of eight years from when a previous client cut ties, as well as two internal audits of the advisor which, on one occasion, uncovered 27 high-rated, and 24 medium-rated, non-compliance issues.

Similarly, it was reported on 4 April 2018 that nearly 40% of sales by Aussie Home Loans were products of the Commonwealth Bank or a subsidiary. This is despite CBA having a market share of around 25%. Brokers were also eligible for benefits or gratuities when they up-sold customers Aussie branded insurance policies. Aussie are wholly owned by CBA.

Conversely, an article in AFR on 26 April 2018, discusses Citi Private Bank’s fee for service model. Under Citi’s model, a comprehensive ban on commissions has been implemented, as well as what global head of Citi Private Bank, Peter Charrington, described as an “agnostic” approach to their services, which allows financial planners working for Citi to recommend any product, from any institution, so long as that product is the best fit for the client. AFR presented this case study as a potential future direction of the financial planning industry.

Independence Issues

On 18 April 2018, the Royal Commission alleged that AMP's chair, Catherine Brenner, and former CEO, Craig Meller, interfered with a report by law firm Clayton Utz that was commissioned by AMP after self-reporting fee for no service breaches to ASIC. On 18 April 2018, it was reported that over 700 emails were exchanged between Clayton Utz and AMP, that Meller specifically requested his name not be mentioned in the report, and that Brian Salter, AMP's legal counsel and former Clayton Utz partner, sought to directly change the wording of a conclusion by Clayton Utz.

This is, however, disputed by AMP. On 7 May 2018, AMP were reported as stating to the Royal Commission that law firm Clayton Utz decided to remove Meller's name without any direction by AMP. Similarly, on 9 May 2018, AMP were reported as stating the majority of the abovementioned emails were either duplicates, calendar invites, RSVPs, or administrative in nature, and were not an indication that the report was heavily influenced.

Over the weekend of 21-22 April 2018, it was reported that AMP did not believe Brenner had acted unethically, and that her requests kept to the factual findings of the report. Pauline Vamos, CEO of governance firm Regnan, was quoted as saying, "it is usual for facts to be verified with the company to ensure all information has been considered and taken into account – however any conclusions derived from the facts must be the reporters alone."

It was further reported by AFR on 1 May 2018 that Catherine Brenner's letter to Clayton Utz commissioning the report stated that the report was to be considered legal advice, and that legal advice can hardly be considered independent. The contention therefore surrounds AMP's submission to ASIC that the report was, in fact, independent. Making a false or misleading statement to ASIC carries a maximum penalty of a \$42,000 fine, or five years' imprisonment. Clayton Utz were also reported as indicating the report was only considered independent of the advice business of AMP.

Separate to the reports of interference by AMP in the report by Clayton Utz are allegations, arising in the AFR on 19 April 2018, that AMP automatically deducted advisor fees from customers' wrap platform, and, where there are insufficient funds to pay this fee, the platform automatically disposes of assets to cover these fees. This may be happening even without customer approval – a requirement of FoFA legislation.

Regulatory Issues

On 1 May 2018, it was reported in the AFR that AMP had admitted to the Royal Commission that they had both paid and received commissions which had been outlawed under FoFA. This is covered in more detail under the topic 'Commissions,' above. Specific regulatory breaches stemming from this were misleading ASIC 20 times – four of which were false or misleading statements, one in which AMP insisted no personal advice had been given, when in fact this was not true. Further, there is contention surrounding a report, submitted to ASIC as independent, which was subject to edit requests by AMP management (see Independence Issues, above). Representing AMP at the Royal Commission, Jack Regan admitted that, while some of these instances were a breakdown in procedures, others were a deliberate attempt to mislead the regulator.

There was an instance where AMP submitted a copy of a template of a letter to customers advising that service fees would be removed from their account, but they did not send this letter to all customers. In another instance, AMP advised ASIC that an audit by PwC, "has not identified any systemic issues about the provision of ongoing services by AMP advisors." PwC's report, on the other hand, stated that there had been no root cause analysis and they were, therefore, unable to identify any systemic issues.

Approximately 2.5 years before the formation of the Royal Commission, APRA became aware of regulatory issues at CBA, in particular with their data management systems. There were instances of poor data control, overcharging, and approximately 53,000 individual breaches of the anti-money laundering act, where CBA failed to notify AUSTRAC of transactions in excess of \$10,000. Following this, KPMG was appointed to review internal auditing and LVR ratio data. This report only found 'minor' issues with CBA's data. Following this, APRA released a final report into CBA's governance, culture and accountability on 1 May 2018, with a number of findings.

CBA's culture of "complacency and arrogance," AFR reported on 2 May 2018, led to a decreased focus on risk management. This was compounded by the Board's reluctance to challenge senior management, relying on what APRA labelled "raw intellect over analysis." Graeme King, president of the Business Council of Australia, was quoted as saying the report provides "deep insights and guidance to all businesses about the standard of governance expected of them." Elizabeth Proust was quoted as saying, "all Boards will be looking at what this means for them."

APRA was critical of CBA's culture of 'can,' and instead posed the question, 'should we?' before issuing 35 recommendations to the CBA Board, including aligning CBA with global risk management best practices. They criticised CBA's compliance function's lack of authority, recommending the establishment of a non-financial risk committee. One of the key recommendations reads, "Senior leaders should reinforce key behaviours of increasing self-reflection, giving and receiving constructive feedback, and dealing with conflict effectively."

The culture of CBA was further criticised by James Thompson, who accused the bank of "complacency through profitability." According to Thompson, the bank, "created a collective belief within the institution that CBA was well-run and inherently conservative on risk." Thompson also quoted the

APRA report when stating that CBA were unwilling to learn from mistakes, insular, and desensitised to customer complaints.

Craig Drummond, CEO of Medibank Private was quoted in response to the APRA report, the “primary purpose (of business) is to serve our customers.” “that means all the executives need to be speaking to customers, understanding customers’ issues.” “If you do a great job for customers, you will ultimately generate a satisfactory return.”

APRA imposed a \$1 billion penalty capital holding, reducing CBA’s capital position to the worst of the Big 4. On top of this are \$210 million in penalties, as well as the cost of employing 800 full-time staff, increased IT costs in order to lift compliance.

Separate to APRA’s report was a settlement with ASIC, reported by AFR on 10 May 2018, where CBA admitted to unconscionable conduct in manipulating the bank bill swap rate in 2012. CBA, NAB, and ANZ all settled, with the latter two being fined approximately \$50 million each, while Westpac chose to take the matter to trial and is awaiting judgement, due later this year. CBA: “acknowledge that, in the course of trading on the BBSW market in Australia on five occasions between February and June 2012, CBA attempted to engage in unconscionable conduct in breach of the ASIC Act. CBA will also acknowledge it did not have adequate policies and systems in place to monitor the trading and communications of its staff in order to prevent that conduct from occurring.”

Meanwhile, ANZ admitted that, in an internal audit in 2015, found that one in twenty pieces of financial advice would fail the best interest test imposed by FoFA in 2013. More generally, Anna Bligh, CEO of the Australian Banking Association, warned of “change fatigue” in the banking industry, saying we live in an age where the public insists on, “instant policy, instant legislation, and instant implementation and compliance.”

Bernie Ripoll, chair of the FoFA inquiry, was quoted as anticipating increased rules, regulations, compliance obligations, and, ultimately costs, as a result of the major banks’ behaviour.

Misconduct

Over the weekend of 21-22 April 2018, it was reported in the Australian Financial Review that the former IT general manager for CBA is facing bribery and corruption charges, relating to the purchase of \$10.5 million worth of unnecessary software. Similarly, an investigation by NSW police into an alleged fraud between NAB's former chief of staff, Rosemary Rogers, and Human Group's CEO, Helen Rosamond, with accusations of overcharging and kickbacks between Rogers and Rosamond surrounding contracts for NAB events.

A former ANZ financial planner, Chris Harris, was the focus of the AFRs commentary of the Royal Commission, with claims by ANZ that he provided inappropriate information to customers and was regarded as "difficult" by the bank, with a long history of poor performance ratings. In one case that was presented to the Commission, Harris presented advice to a client relating to their superannuation that would take 14 years to break even. In another case, he advised an elderly client to invest her savings in a wrap product, which was described by ANZ as "inappropriate" for her age and income.

Meanwhile Westpac were accused by the Royal Commission of not warning Dover Financial Planning that Andrew Smith was churning customers through products to generate fee revenue, charging fees for no services, failing to keep appropriate records, and requesting customers sign blank documents. Smith was labelled "extremely high risk" after being audited by Westpac, who failed to give details to Dover about their concerns regarding Smith. When asked for a reference, Westpac only said, "there were concerns about his conduct" and there was an "under-going investigation" due to uncertainties regarding the bank's legal obligations.

Fallout, Repair and Reform

AMP have so far lost six board members and senior staff – chairperson Catherine Brenner, senior legal counsel Brian Salter, CEO Craig Meller, and three other board members – Vanessa Wallace, Holly Kramer and Patty Akopiantz. Wallace and Kramer resigned after it became clear that a large protest vote against them would occur, whilst Akopiantz, who was not up for election, was at the time of her resignation AMP’s longest-serving director. CGI Glass Lewis, a proxy advisory service, recommended voting against Kramer and Wallace, saying, “We believe the board’s actions, or lack thereof, constitute governance failures” of the board. Bell Potter was quoted by AFR as expecting the entire board to eventually step down, the Australian Shareholder’s Association called Catherine Brenner’s position “untenable” prior to her departure, and the Australian Council of Superannuation Investors recommended voting against sitting directors Kramer, Wallace and Andrew Harmos prior to Kramer and Wallace’s departure. Institutional Shareholder Service recommended supporting all three.

The Australian Financial Review reported that up to 40% of the \$11 million in bonuses paid last year could be clawed back by AMP, and that investment firm Vanguard had purchased 5.1% of shares in AMP, capitalising on the low of \$4.05 that was experienced in late April, down 26% from a high of \$5.47 in early March.

On 24 April 2018, Australia Post announced that they were reviewing the decision in 2013 to use AMP as their default superannuation fund, with AFR quoting the Communications Workers Union as saying in a letter to Australia Post, “the union, in light of these developments, is seriously concerned that our members’ retirement savings are being managed by AMP. Therefore, I am urging you to review AMP’s continued position as the default superannuation fund provider to corporation’s employees.”

Mike Wilkins has been appointed AMP’s interim CEO, with David Murray the new chair. Both are expected to set about finding a new CEO and repairing the damage caused by AMP’s fee for no service and independence scandals. Murray contrasted the fallout from the Royal Commission to the Takata airbag scandal, where car manufacturers were given time to fix the problem in a “measured way.”

AMP in particular is facing the possibility of criminal charges in relation to misleading ASIC on the independent nature of the Clayton Utz report into AMP’s fee for no service scandal, and it was further reported by the AFR on 30 April 2018 that the Royal Commission is considering recommendations including a prohibition on vertical integration, which would trigger major asset sales and lowered revenue for the major banks. They also flagged removal of grandfathered commissions altogether, and outlawing ongoing service fees, which were described as “problematic.” Counsel assisting Commissioner Hayne, Rowena Orr, QC, was quoted as saying of AMP’s Jack Regan, “Mr Regan’s view was that a fee (for service) arrangement was much more consistent with a professional environment.” Westpac’s Michael Wright was quoted as saying he couldn’t wait for the day when they become fully fee for service. ASICs Peter Kell: grandfathered commissions drive “the wrong sort of behaviour. They can encourage advisers to retain clients in products which enjoy grandfathered remuneration” even where this is not in the client’s best interests.

The Commonwealth Bank are also facing reputation damage, after dropping 21 places in the Corporate Reputation Index, as reported by AFR on 19 April 2018, and are considering selling financial planning arms Count Financial and Financial Wisdom.

ANZ have reported increased scrutiny of mortgages, with increased checks on applicant identity, income, qualifications and capacity to repay in order to boost their responsible lending practices, off the back of AFR's David Rowe warning of regulatory overreach in a column published 21-22 April 2018.

More generally, APRA's former head of governance, Fahmi Hosain, has predicted a paring back of financial-based performance metrics in pay schemes, and Macquarie University financial services remuneration expert Elizabeth Sheedy is sceptical of "whether short-term bonuses have any place in the industry at all."