CERA Global Risk Conference 2021

from 14 to 17 June 2021

Presented on actuview

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ERM Learnings From The Australian Financial Advice ‘Fees For No Service’ Issue

Tim Gorst FIAA CERA

^ As adapted from original 2019 Australian Actuaries Insights Session

Outline

1. Introduction - the non-financial risk challenge to actuaries
2. Australian Fee For No Service misconduct - what happened?
3. Was the risk understood?
4. Where was the RMF weak?
5. Key insights and discussion

Regulators Agree on Non-Financial Risk Management

"…. on the whole, the issues that have caused industry the most grief over recent years stem from the failure to identify and mitigate against non-financial risks ….. (which when) left unaddressed, the consequences become distinctly financial in nature."

John Lonsdale, APRA Deputy Chairman - 2019 Actuaries Summit

"But if there's anything that we've learned in the last 18 months it is that non-financial risks are incredibly important …"

James Shipton, ASIC Chairman - September 2019 AFR Interview

Challenge to Actuaries

"To be truly effective, actuaries must be prepared to probe, test and challenge boards and management about the wisdom of their decisions, and potential risks they may not have fully considered …. (and vitally) beyond the realm of traditional financial risks."

John Lonsdale, APRA Deputy Chairman - 2019 Actuaries Summit

Key ERM Questions

1. Have we identified, and do we understand, the most important risks?

2. Are they being, or will they be, effectively managed?

3. Do we have enough, and the right type of, capital?

Fee For No Service Misconduct - What Happened?

- Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry **(RC)**
- Customers charged ongoing fees for financial advice services that were not provided, or not correctly provided
- Predominantly the wealth businesses of the 4 major banks, AMP and StatePlus Super, but with other entities also affected
- Ongoing regulatory investigation for potential breaches of law with well over $1b to be returned to customers

A Fee For No Service Risk Definition

The risk that customers might be charged an advice fee for services:

- **Contracted to deliver but service not delivered**
  - e.g. no linked adviser, linked adviser not performing the expected service
- **Without a clear or known contractual basis to do so**, irrespective of whether a service was delivered or not
  - e.g. advice fees charged on corporate super delinks without a member opting in, advice fees charged to deceased estates

Context - Community Expectations

"… charging for what you do not do is dishonest. Although this should have been obvious to everyone, the practice of charging 'fees for no service' has been endemic in the financial advice industry."

"Until satisfactory steps have been taken to deal with those involved in the charging of 'fees for no service', and to ensure that it does not happen again, the financial advice industry will lack the public respect and trust that is a necessary aspect of any profession."

Royal Commission
into Misconduct in the Banking, Superannuation and Financial Services Industry

Kenneth Hayne, Commissioner

Context - Legacy Products

- Older style "bundled" products and platforms sometimes made it unclear what service was actually being paid for.

"… the services to be provided under ongoing fee arrangements often were, and still are, neither well-defined nor onerous …. loosely defined but also defined in a way that has little or no substantive content beyond a promise to speak with the client once each year."

"fees charged under ongoing fee arrangements were, and still are, often charged 'invisibly'"

Royal Commission
into Misconduct in the Banking, Superannuation and Financial Services Industry

Kenneth Hayne, Commissioner

Context - Inherent Conflicts

"The adviser stands to earn, and to continue to earn, annual amounts from the client. The less the adviser does before the fee is paid, the greater the financial advantage."

Royal Commission
into Misconduct in the Banking, Superannuation and Financial Services Industry

Kenneth Hayne, Commissioner

- RC recommendation (2.4) - repeal of provisions previously put in place by the regulator (ASIC) to enable the grandfathering of legacy "conflicted remuneration"

Context - Traditional Australian Financial Service RMF …

Board Policy, Strategy and Review

Material Risks, Risk Appetite & Limits	Risk Management Strategy	Strategy & Business Plan	RMF Review & Improvement

Risk Management Enablement

Policies & Regulatory Standards	Roles and Accountabilities	Risk Governance	Risk Culture (Incentives)

Risk Management Application

Risk Identification, Evaluation & Treatment	Risk Measurement, Modelling & Reporting	Capital Management / ICAAP	Risk Event Management

… reshaped post RC

Risk Management Strategy

Strategy & Business Plan

Material Risks, Risk Appetite & Limits

RMF Review & Improvement

Core

Roles and Accountabilities

Risk Governance

Risk Culture (Incentives)

Policies & Regulatory Standards

Risk Event Management

Capital Management / ICAAP

Risk Identification, Evaluation & Treatment

Risk Measurement, Modelling & Reporting

Context - Core RMF Weakness

Risk Management Strategy

Strategy & Business Plan

Material Risks, Risk Appetite & Limits

RMF Review & Improvement

Roles and Accountabilities

Core

Policies & Regulatory Standards

Risk Governance

Risk Culture (Incentives)

Risk Event Management

Capital Management / ICAAP

Risk Identification, Evaluation & Treatment

Risk Measurement, Modelling & Reporting

^ assessment by Tim Gorst with reference to RC report

Accountability, Governance & Culture

"… the root cause of the fees for no service conduct was greed: greed by licensees, and greed by advisers"

Royal Commission
into Misconduct in the Banking, Superannuation and Financial Services Industry

Kenneth Hayne, Commissioner

"If what has happened in the past is to be avoided in the future, entities have no choice but to grapple with culture, governance and remuneration. All three are related."

"Failings of organisational culture, governance arrangements and remuneration systems lie at the heart of much of the misconduct examined in this Commission …… regulators also have an important role to play in the supervision of culture, governance and remuneration."

Accountability, Governance & Culture

- **Industry "blindness"** to the fact they were doing the wrong thing (carelessness and complacency)
- **Incentive misalignment**
- **Lack of oversight** from relevant Boards (inadequate governance) including a lack of challenge to management (e.g. around remediation approach and timeliness)
- Lack of **customer advocacy**
- **Unclear accountabilities** helping to explain recommendation to extend banking accountability regime to other APRA regulated entities

Risk Maturity Assessment

4 risk maturity (culture) possibilities in relation to the Fee For No Service issue

- **Mechanical** - Risk identified, understood but poorly controlled (e.g. advice fees with unlinked advisers)
- **Compliance** - Risk identified but not properly understood (e.g. advice fees with linked advisers, no service being provided, but maybe it isn't legally wrong?)
- **Risk Unaware** - Risk not understood (e.g. Adviser Services Fees and deceased estates)
- **Immoral** - Knew it was wrong but did it anyway

Control Framework

- **Control Weakness** - absence, or ineffective working, of risk management controls (preventative, detective and corrective)
- **Legacy Product Risks** - originally designed in a different regulatory era
- **Legacy System Risks** - expensive to retrofit with automated controls

“some licensees and advisers did not keep adequate records to enable monitoring and analysis” …. “some licensees did not develop and enforce effective monitoring and checking procedures to prevent systemic failures.”

Royal Commission
into Misconduct in the Banking, Superannuation and Financial Services Industry

Kenneth Hayne, Commissioner

Other RMF Weaknesses

- **Strategic Risk** - Was risk properly considered in Board strategies to offer and / or facilitate "personal advice"?

- **Regulatory and Policy Protection** - Did the previous regulatory requirements go far enough to protect consumers? Why didn't internal Board policies go further?

- **Event Management** – Were Boards involved enough in resolution of the issue, or was it left to management to resolve?

"… APRA was invisible after repeated instances of fees for no service conduct were reported to it …"

Royal Commission
into Misconduct in the Banking, Superannuation and Financial Services Industry

Kenneth Hayne, Commissioner

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APRA Post RC Request of the Industry

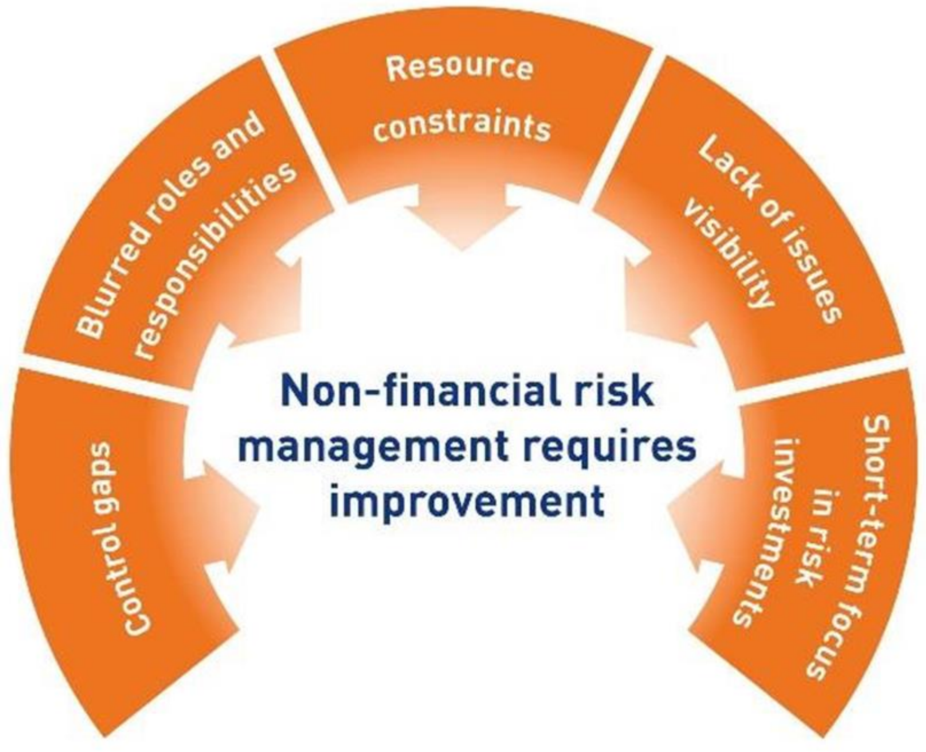
1. Improve non-financial risk management

2. Make risk accountabilities clearer

3. Address known weaknesses

4. Improve understanding and assessment of risk culture

APRA May 2019 Information Paper – Self -assessments of governance, accountability and culture



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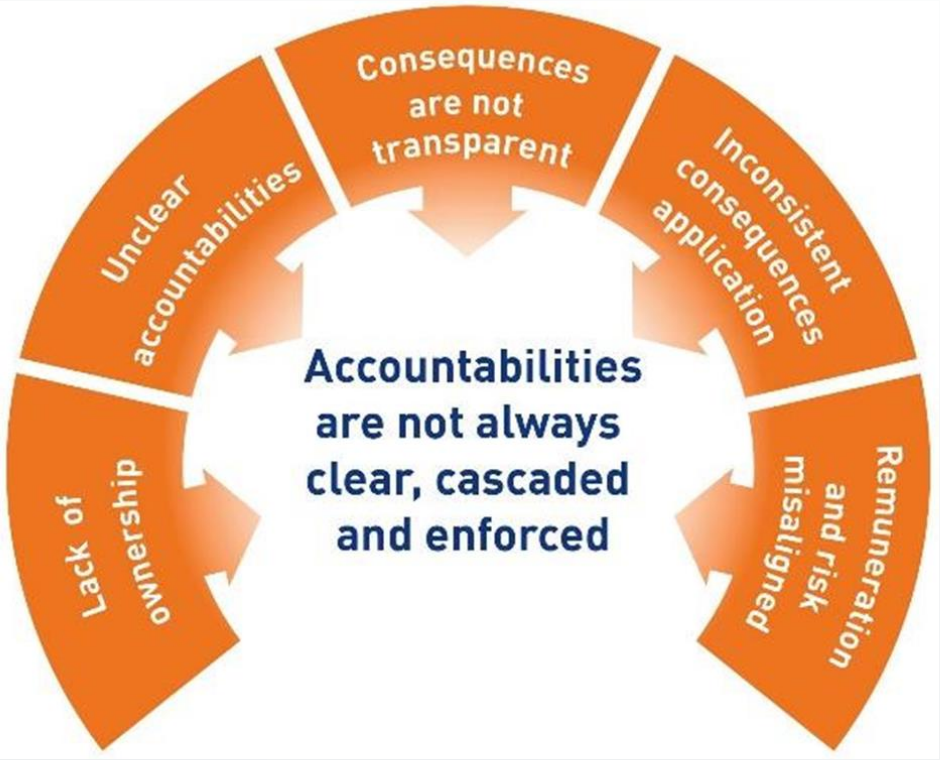

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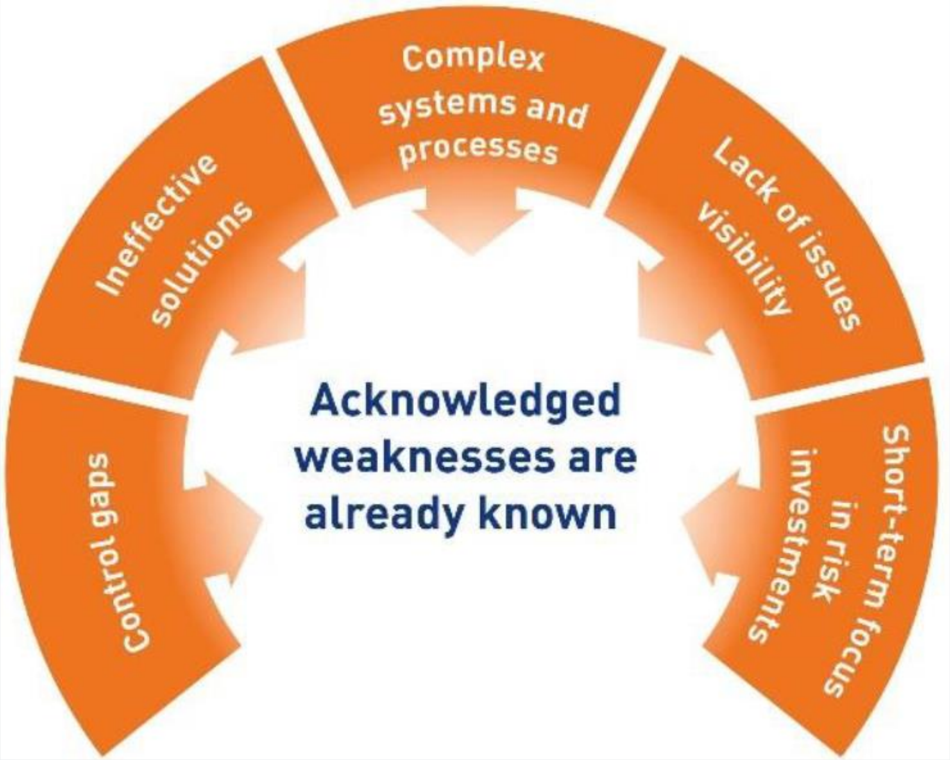

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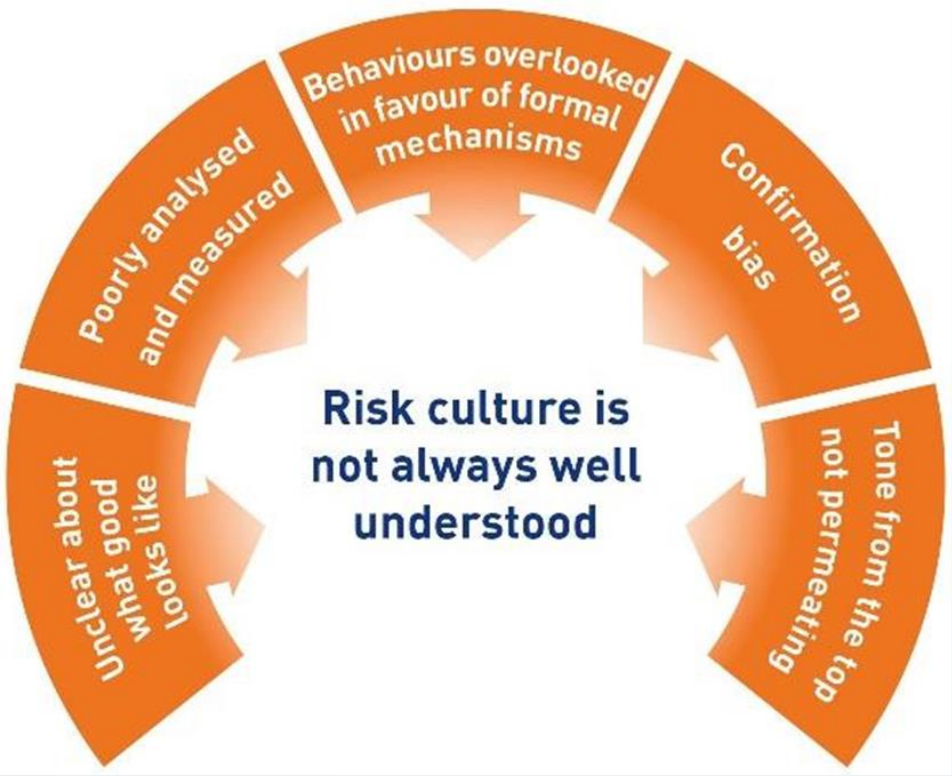

More From the Regulators

“Most global financial institutions, in the light of experience, have developed a sense of ‘chronic unease’ about the potential threats to their financial and reputational standing from non-financial risks, and their risk culture and risk management frameworks have evolved in line.”

APRA Inquiry Into The Commonwealth Bank of Australia - April 2018

“Organisations, companies and financial institutions that don't have the infrastructure, the wherewithal, the mindset and the processes around identifying, capturing, diagnosing and dealing with non-financial risks do so at their peril and the peril ultimately of that trust in the broader system.”

ASIC Commissioner Sean Hughes Speech to the RMAA - 10 September 2019

Revisiting Key ERM Questions

1. Did the industry identify and understand Fee For No Service related risk?

RC says no - to the point of being completely unaware in some cases

2. Did the industry effectively manage Fee For No Service related risk?

RC says no - RMF hotspots in relation to governance, culture and control framework

3. Was capital adequate?

RC says no - particularly in relation to non-financial capital (products & controls, people & culture, community trust).

Key Insights

- **The community needs actuaries to help manage non-financial risks** - ask the 3 key ERM questions at the right time, place and context.

- **Culture, accountability, governance and remuneration**
  - core to the RMF, and explain much of the Fee For No Service issue. Expect intense regulatory supervision on these elements going forward.

- **Invest in managing risk for the long term**
  - strategic risks and engineering / integrating automated controls to manage these risks. Over time, manual controls (cheaper option) could cost more.

- **Legal compliance is no longer enough to cover risks**
  - with community expectations setting the social risk minimum bar.

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