

Australia's financial system was designed for plunder

From its inception, Australia's modern financial system was designed to enable decades of plunder of ordinary Australians, serving up retail investors—"mum and dad investors"—as cannon fodder for the banks. Australia's financial regulation was based on the recommendations of the 1997 Wallis Inquiry, which designed Australia's "light touch" regulatory system and the role and powers of the regulator, the Australian Securities and Investments Commission (ASIC).

The fundamental policies developed by the banker-run Wallis Inquiry, headed by former AMP Chair Stan Wallis, were based on the now-discredited "efficient markets theory", an ideological premise that the market would solve all ills. Therefore, the Inquiry recommended regulatory intervention should be kept to a minimum, with a preference for the industry to self-regulate through voluntary codes of conduct. In the words of former ASIC Chair Greg Medcraft, Australia's financial regulation "is based on self-execution and relies on people to do the right thing". ([AAS, 13 Oct. 2021.](#))

The 2018 Financial Services Royal Commission's Background Paper 7, "Legal Framework for the Provision of Financial Advice and Sale of Financial Products to Australian Households", outlined the influence of the Wallis Inquiry and subsequent financial reforms. It observed that "by the beginning of the century the regulatory design die was effectively cast ... key assumptions and decisions made in the late 1990s have had a significant impact on where we are today ... they help explain why the current legal framework functions the way it does". However, *dysfunction* is the more appropriate descriptor for the current regulatory framework, which, as Medcraft admitted in 2014, has made Australia a "paradise ... for white-collar [criminals]".

As well as giving the green light for decades of financial predation by designing a "self-regulating" financial system, the banker-run Wallis Inquiry also effectively threw ordinary Australians to the corporate wolves, by determining that there should be no restrictions on the type of financial products which could be sold to everyday people, no matter how risky or complicated.

As acknowledged in Background Paper 7, one of the important decisions of the Wallis Inquiry "was that household access to wholesale markets and complex products would not be restricted. There would be no categories of financial product that were restricted to sophisticated clients". This included the specific recommendation that retail clients should be able to access OTC derivatives markets (over-the-counter—risky financial betting). The Wallis Inquiry's approach to consumer regulation "was based primarily on disclosure. It did not restrict either the design of financial products or the type of financial products that could be marketed to retail clients. The focus of consumer protection was on regulating disclosure rather than products themselves". If the seller of a financial product could meet the disclosure requirements, "any product—including complex and leveraged products and exotic forms of alternative investments—could be offered to the retail market. Clients were 'assumed to be the best judges of their own interests'."

Dysfunctional regulation devastates everyday Australians

In the Royal Commission Background Paper 6 (Part C), "Financial Products Available to Retail Investors", it was observed that after the 2008-09 Global Financial Crisis, "the limitation of a predominantly disclosure-based approach to retail investor protection became evident when it became apparent that significant numbers of Australian consumers held financial products that did not suit their needs and circumstances and in some cases, resulted in severe financial loss".

The 10,000 submissions to the 2018 Banking Royal Commission were indicative of the extent to which ordinary Australians have suffered because of our dysfunctional regulatory regime. In the years prior to the Royal Commission, earlier Senate Inquiries had revealed the devastation incurred through unsafe financial products being sold to unsuspecting mum and dad investors. In a 2011 study on the social impact of monetary loss, ASIC examined a small sample of retail investors, including soon-to-be retirees and people on a disability pension, who had suffered significant financial losses because unscrupulous financial advisors advised them to buy unsafe products, of which the investors did not understand the risks. ASIC's study documented the "catastrophic" consequences these retail investors experienced, some of whom said their lives would never be the same again. They now went without meals, could not afford to buy medication or to keep their fridge running, or had developed serious illness because of the stress. Many blamed themselves, engaged in "mental selfflagellation" and spent "sleepless nights worrying about their own naivety and culpability". The loss had terrible impacts on their personal relationships. Some said the only reason they survived was their obligation to look after their children.

As determined by the Wallis Inquiry, Australia's financial regulation is based primarily on disclosure, not regulating the actual products themselves. This has provided a loophole for corporate crooks to deliberately mislead retail investors into putting their hard-earned wealth into unsafe financial products. In a 2014 Senate Inquiry into ASIC, initiated after scores of ordinary Australians were defrauded out of their life savings and homes by predatory financial professionals and corrupt banks, consumer advocates identified the catastrophes of Westpoint, Storm Financial and Opes Prime as examples where the so-called "disclosure" documentation was anything but. Documents provided to unsophisticated retail investors were very lengthy or difficult to understand, contained omissions, or

included inferences which would require legal training to understand. One consumer advocate observed that the actual financial products were so poor that a consumer would have to be misled to enter into them.

The Committee's report contained numerous criticisms of ASIC's regulatory inaction when presented with misconduct. The report observed that ASIC argued that: "[c]onsistent with the underlying philosophy of the financial services regulatory regime", i.e. the efficient markets theory, "ASIC's role is not to control the types of products that are available in financial markets, to prevent investments from failing, or to place checks on investors' investment decisions."

A number of participants in the inquiry essentially blamed retail investors for expecting too much of ASIC. It was recognised that there was an inaccurate public perception about the extent to which ASIC would, or could, protect consumer interests. Notably however, the final report of the 2018 Financial Services Royal Commission observed that "ASIC is charged with enforcing financial services laws on behalf of the community. One of ASIC's objectives is to 'take whatever action it can take, and is necessary, in order to enforce and give effect to the laws of the Commonwealth'. *The community is entitled to expect*, and does expect, that financial services entities will comply with those laws". (Emphasis added.) This includes the legal obligation to provide financial services "efficiently, honestly and fairly"

Scamming retail investors is a lucrative business

Speaking on the 2016 release of the Senate Inquiry report titled "Bitter Harvest", Greens Senator Peter Whish-Wilson observed that retail investors had lost nearly \$4 billion in the "absolute catastrophe" of agribusiness managed investment schemes, which were "Australia's mini GFC moment". Whish-Wilson stated that the "whole thing was a house of cards from the start", yet it was not until the last afternoon of the inquiry that ASIC admitted the financial products were not retail investment grade. Financial advisors and accountants had recommended tens of thousands of mum and dad investors, some of whom leveraged borrowed money, to buy the high-risk products as a purportedly "safe as houses" taxdeduction strategy, which was formally established in 1998, in the wake of the Wallis Inquiry. As Whish-Wilson observed, although the companies and banks involved knew it was a Ponzi scheme, the banks, including Bendigo Bank and ANZ, profited from the wholesale looting of ordinary Australians who did not understand the risks, while cleverly shielding themselves from any risk.

This is a consistent theme resulting from the misconduct of financial professionals and numerous corporate collapses which have wiped out the life savings of retail investors— ordinary Australians— while the banks profited, shielded from liability or genuine scrutiny. The current regulatory system, while a disaster for everyday people, has been extremely lucrative for Australia's Big Four, which are among the world's most profitable banks. As the Royal Commission Background Paper 6 (Part C) observed, the "strongest form of retail investor protection—the outright prohibition of certain specified financial products for retail investors— has not to date featured prominently in Australia". It is obvious why. As of December 2017, \$5 trillion (49 per cent of total net worth) in financial assets were attributable to Australian households, which included currency and deposits, superannuation, shares, insurance and securities. In Australia, a white-collar crime "paradise", this \$5 trillion is ripe for the picking. Troublingly, it seems the regulator intends this to escalate. As reported by the 21 September 2021 *Australian Financial Review*, the new Chair of ASIC, "business-friendly" ex-Deutsche Bank lawyer Joe Longo, recently signalled a new era of corporate free-for-all. When Longo said that oversight of the financial advice industry would "not increase" under his watch, and "warned that a more deregulated market *put the onus on investors* to be informed about the advice they receive and the risk of market losses" (emphasis added), he was effectively declaring open season on retail investors.

The Sterling First scandal takes regulator-enabled retail investor predation to new depths. The 140 elderly tenants, who had prepaid forty-year rental contracts, had no idea they were deemed to be "investors" until after Sterling First collapsed. Even early documentation published by the administrator referred to the elderly victims as "tenants". Scandalously however, ASIC persists in misclassifying the elderly tenants as "investors", despite all evidence to the contrary, in order to play ASIC's time-worn "we don't interfere with investment decisions" excuse, otherwise known as the "buyer beware" card, and thereby avoid responsibility for its appalling regulatory failures.

More than 3 million Aussies are now 'sophisticated investors'



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The number of Australians who meet the so-called wholesale investor test has blown out from just 1.9 per cent of the population in 2002 to more than 16 per cent, leaving more than 3 million consumers vulnerable to risky investments and conflicted financial advice.

Modelling conducted by Australian National University associate professor Ben Phillips has found 1.09 million households (or 3.25 million individuals) meet the legal definition for a sophisticated or wholesale investor.

This means they have at least \$2.5 million in assets or annual income exceeding \$250,000. In 2002, when the rule was implemented, just 104,000 households eligible to be accredited as wholesale by an accountant.



'Sophisticated investor' loophole

One of the measures instituted in wake of the Wallis Inquiry was the "sophisticated investor" test, which allowed investors who met certain criteria, including a threshold of \$250,000 in annual income or \$2.5 million in net assets, to access riskier wholesale markets. However, these "sophisticated investors" would also forfeit certain rights and consumer protections which are (supposedly) extended to retail investors.

The "sophisticated investor" provisions have been consistently exploited. For example, in 2017 ASIC warned that accountants were deceptively using trust or company structures to misclassify retail investors as "sophisticated". On 31 May 2018 ABC News reported that Macquarie Bank had been routinely classifying customers as sophisticated investors, which legally allowed the bank to invest their money in high-risk products without having to explain why or outline the potential consequences. The ABC documented one such couple who Macquarie classed as sophisticated investors because of the value of their farm, despite the fact that they had no experience in the share market. The couple lost nearly all of their retirement savings after Macquarie put them in a high-risk trading category, and claimed \$700,000 from the couple in fees.

The 2 March 2020 *Australian Financial Review* reported that the misclassification of investors as sophisticated was a "widespread" problem. The Australian Financial Complaints Authority (AFCA) warned that "clients are being shoe-horned into risky financial products by advisers who are dubiously classifying them as 'sophisticated' investors", because they passed the income and asset threshold. According to AFCA Ombudsman Jacqueline Pirone, this included "not very financially savvy" widows, self-managed superannuation funds, home owners and beneficiaries of wills.

Curiously, in addition, when the twenty-year old "sophisticated investor" threshold criteria was originally legislated, it was not indexed. As reported by the 11 October 2021 *AFR*, taxation and welfare expert Dr Ben Phillips, associate professor at Australian National University, observed that ordinarily, economic public policy contains an "in-built indexation mechanism" against inflation or wages. Although Phillips described the lack of indexation as an oversight, the *AFR* reported that "some market sources said the decision not to update or amend the test was more deliberate and the result of vested interests in the wealth management industry".

Dr Phillips' recent research, which was commissioned by investment manager Coolabah Capital, was believed to be the first to calculate the number of Australians who, because of inflation, had since shifted into the "sophisticated" parameters. Phillips' modelling showed that rising house prices meant that 16 per cent of Australians (3 million people) were now deemed to be "sophisticated investors", compared to just 1.9 per cent of the population in 2002. Using Reserve Bank of Australia and Treasury income and asset price assumptions, this number could reach 6.78 million people (29.1 per cent) by 2031, and 11.5 million people (43.6 per cent) by 2041. Regardless of their financial literacy, almost half of all households (49 per cent) could be classed as "sophisticated investors" over the next twenty years if wage growth was even moderately stronger than expected, leaving large swathes of the public vulnerable to exploitation. This is not accidental—the fundamental design of Australia's financial regulation has served up mum and dad investors as financial cannon fodder since inception.

