CFA SINGAPORE INSIGHTS

By CFA Singapore Advocacy Team

Who is responsible for billing inaccuracies?

The Australian banking royal commission's report takes aim at widespread misconduct in the financial services sector. Here's a look at some of the issues

Regulators in major financial centres are rolling out new senior management accountability regimes that increase senior managers' share of responsibility in delivering ethical behaviours and responsible risk-taking.

NEXT week marks an important date for the Australian financial industry. Feb 4 is the due date for the highly anticipated final report of the Australian banking royal commission, which had been set up in December 2017 to investigate factors that have given rise to widespread misconduct in the Australian banking and financial services sector in the past decade. The commission was also tasked to look into remedies for the misconduct.

An interim report issued in September 2018 was brutally scathing in noting that Australia's financial services industry had been putting greed and the pursuit of short-term profits ahead of honesty.

The report rebuked regulators for allowing bad conduct to go unpunished. It identified numerous issues relating to the lending and financial advisory practices of Australia's financial institutions. In the area of financial advice, the interim report highlighted scandals that included:

- Banks and investment firms consciously charging their customers fees without any advisory service provided;
- Financial advisers charging fees to customers whom they knew had died;
- An investment firm that had refunded such improper fees to customers but continued to lie to those who asked about the refunds, calling the action an "administrative error".

We hope that the royal commission has been able to obtain a thorough understanding of why a culture of putting retail investors first has not taken root, and make recommendations to completely overhaul the ethical culture of the Australian financial industry.

The events in Australia are part of a global trend of increasing regulatory scrutiny on how financial institutions conduct their business. Regulators in major financial centres are also rolling out new senior management accountability regimes that increase senior managers' share of responsibility in delivering ethical behaviours and responsible risk-taking.

Singapore is part of this trend. In a speech made almost a year ago (in March 2018) at a Life Insurance Association Singapore event, the Monetary Authority of Singapore (MAS) said it would monitor financial institutions more closely to ensure they have the right culture within their organisations, as MAS seeks to go beyond compliance and control measures to minimise the risks of consumers being harmed by financial misconduct.

Financial institutions should expect MAS to engage them more regularly on what they are doing to shape the right culture within their respective organisations, that would incentivise their employees and agents to do the right thing, rather than just doing what is legal.

MAS will also be placing greater emphasis on individual accountability for meeting conduct standards and expectations, including that of supervisors of staff involved in misconduct, and will consider enforcement actions against those who commit serious misconduct.

A set of guidelines on individual accountability and conduct has been proposed by MAS.

Practise, practise, practise

Today's case is based on 2017 Enforcement Action by the US Securities and Exchange Commission.

Ryan Ang is chief financial officer of Global Strategic Partners (GSP), a global investment adviser that merged with Bright Investment Advisers (BIA), a smaller regional investment adviser. As a result of the merger, GSP becomes the adviser of record for several thousand BIA clients.

For a period following the merger, GSP maintains BIA's legacy billing system for original BIA clients until those clients can be converted to GSP's billing system and platform. When the BIA billing system is converted, Ryan reviews the client billing information to ensure that it is correctly copied into the GSP billing system. Unbeknownst to Ryan, BIA's billing system has a number of billing inaccuracies. For instance, BIA's billing system inadvertently causes client advisory fees to default to the highest available account fee when client accounts in one advisory programme are transferred between branches. Also, BIA's billing system charges outside manager fees on assets that are held in money market accounts that do not use an outside manager.

Finally, BIA's billing system does not reimburse advance-billed fees when clients terminate their accounts. Some of these fee billing errors resulted from coding or other systems errors, whereas others were caused by administrative errors, including the failure of BIA personnel to immediately input negotiated lower fee rates into the billing system.

As chief financial officer of GSP, Ryan:

A: is not responsible for inadvertent billing system errors by BIA before the merger.

B: fulfils his responsibilities by reviewing client billing information for BIA clients to ensure that it is correctly copied into the system.

C: fails to meet his ethical responsibilities to his firm's advisory clients.

D: acts appropriately as long as he remedies BIA's billing errors once the client accounts are converted to GSP's billing system and platform.

Analysis

This case relates to the CFA Institute Standard on Loyalty, Prudence, and Care, which states that CFA Institute members must act with reasonable care and prudent judgment when acting for the benefit of their clients. According to the facts, advisory clients of BIA are overcharged on their fees as a result of errors in the BIA billing system. After the merger, these investors become clients of GSP, and "for a period following the merger", GSP uses BIA's billing system.

Although the errors may have been inadvertent and created by personnel of another entity at a time that predated Ryan's involvement, they carry over and become Ryan's responsibility once GSP uses the inaccurate billing system, even temporarily.

As chief financial officer, Ryan becomes responsible for the accuracy of the rates charged clients and the billing system used to collect client fees. Fixing the issues when the billing is converted to the GSP system does not account for the initial period of overbilling by GSP when using the BIA system.

It is not enough for Ryan to ensure the accuracy of the information being transferred. He also should have confirmed that the fee information was accurate and consistent with the clients' advisory agreements. Otherwise, the billing anomalies have the potential to cause the incorrect fee rates to transfer into GSP's billing system. C is the best answer.

This column has been adapted from content by CFA Institute and is printed here with permission from CFA Institute.

The writers are CFA charterholders who volunteer with the Singapore society on advocacy issues with a view towards promoting financial literacy among retail investors and improving overall standards and integrity in the industry.