Governance News

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Diversity

Falling off the glass cliff? Why appointing women to board positions is not enough to accomplish gender parity beyond the short term.

Writing in The Conversation, University of Manchester PhD researcher Susanna Whawell discusses the issue of the 'glass cliff' and its impact on longer term gender parity on boards. In her view, unless the necessary support structures are in place for women appointed to board positions, the broader issue of gender inequality in the boardroom is likely to persist.

What's the 'glass cliff' phenomenon? The glass cliff phenomenon refers, Ms Whawell explains, to the 'phenomenon of women making it to the boardroom but finding themselves disproportionately represented in untenable leadership positions'. In 2005, when the term was first used, researchers presented evidence that though women were starting to secure board seats, they were often appointed to unsustainable/untenable leadership positions from which they would be ousted with evidence of apparent failure creating the 'self-fulfilling prophesy' that women are inherently unsuited to leadership positions.

This finding has subsequently been confirmed through later studies, she writes. 'Not only does it [the perception that women are a riskier proposition than men] knock the confidence of the woman in question, it also makes organisations wary of recruiting women to these positions' she argues.

[Note: A recent example of research confirming the existence of the 'glass cliff' is Velte, Patrick, Appointing Female CEOS in Risky and Precarious Firm Circumstances. A Review of the Glass Cliff Phenomenon (February 5, 2018). Corporate Ownership & Control, Volume 15, Issue 2, Winter 2018. Available at SSRN: https://ssrn.com/abstract=3118128]

Reconciling the glass cliff phenomenon with the increasing numbers of women appointed to board positions: Noting that evidence suggests that women are being appointed to boards in increasing numbers, Ms Whawell suggests that the numbers alone don't tell the whole story: 'the snapshots and headlines' of more women in the boardroom don't tend to include numbers on board turnover, or to reflect the fact that women are over-represented on boards of more 'precarious' companies she writes.

Why do women take on 'glass cliff positions'? According to her analysis, data shows that in most 'glass-cliff' situations the women in question are internal, not external, hires. This suggests, she argues that the women in question are likely to have an understanding of the culture, politics and 'power brokers' within the organisation, yet take on the board position despite it. 'The evidence seems to suggest that these women find themselves with the choice of accepting a glass cliff position or resigning altogether. Having worked for many years to secure a leadership or executive role, it is perhaps less surprising to understand why these women feel a sense of obligation to take on what appears to be an impossible challenge' she writes.

Impostor syndrome? Ms Whawell adds that 'imposter syndrome' — the feeling that you are only successful through luck rather than your own efforts and are at constant risk of being found out — further complicates the issue. Though not confined to women, imposter syndrome tends to impact more women than it does men, she observes, and is likely to be 'particularly acute when a woman is the only female around the boardroom table'. She argues that 'it would seem that one of the possible explanations for a glass cliff scenario presenting itself is that organisations simply fail to consider that women in this position are likely to need a different kind of support in their new role'.

Lack of ongoing support structures to blame? Despite research confirming the importance of support (eg mentoring, coaching) for newly appointed directors, data suggests that this support is often lacking for female board appointees and lack of this form of support is a common characteristic in glass cliff scenarios. She adds that the reason the support is not provided to new female directors remains unclear but what she characterises as the 'benign neglect' shown by organisations towards new female directors is a 'worrying trend'.

Why appropriate support structures are essential to maintaining progress towards gender parity on boards: Ultimately, she concludes, 'It is all very well promoting women into the boardroom, but failing to support them when they are there is equally damaging. Arguably it undoes all of the good work, resources and effort to transition women into the boardroom in the first place'. She adds that 'Helping to create gender parity in boardrooms is widely shown to be beneficial on multiple metrics. But if organisations aren't keeping

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good people in the boardroom because of a failure to appreciate individual differences, then this last hurdle arguably undoes all of the good work that quotas, all-female shortlists, and gender pay gap reporting strives to achieve'.

[Source: The Conversation 12/04/2018]

United States | Numbers are often deceptive? Equilar explains why we shouldn't take every statistic on gender parity at face value.

Referencing an academic study that found there is no meaningful difference in pay between men and women at the CEO level, Equilar outlines through its own worked example, why 'monolithic assumptions [about the issue] are not always fair' and highlights the importance of looking more deeply at numbers, and more particularly, number on diversity.

[Note: The article referenced by Equilar is *Every Day is Like Equal Pay Day for Corporate America's CEOs* 11/04/2018]

Equilar example: Based on its own analysis of the largest US-listed firms to file proxy statements to the SEC before 31 March (Equilar 100 companies), Equilar found that:

- Women CEOs had a higher representation of women on their boards (24% female board representation) on average than companies with male CEOs (23.5% female board representation).
- Women CEOs were awarded, on average, higher compensation in 2017 (average pay package of $21.4m) than their male counterparts ($16.4m).

However, Equilar cautions that though the numbers appear to tell a positive story, 'the complete picture is more complicated than it appears'.

Why the figures don't tell the whole story: Though companies with women CEOs do have slightly more women in the boardroom it's not straightforward to assume, based on these figures Equilar argues, that women CEOs necessarily have more (gender) diverse boards for two key reasons.

1. The data is inclusive of the CEO's current board composition as of 31 March. As most CEOs are also on their own boards, were they removed from the overall numbers, it's likely the data would show that overall, boards are more inclusive of independent women directors when a male CEO is in place.
2. Overall, the sample group of companies has a higher percentage of female directors than other groups ie are more likely to have women on their boards overall. For example, Fortune 500 companies included in the Russell 3000 had an average of 22.5% women on their boards, as compared to 19.2% for Fortune 501-1000 companies and a much lower 14.1% for R3K firms outside the Fortune 1000. The sample group, Equilar writes 'outpaces' each of these groups.

Overall, Equilar comments: 'The facts are the facts—boards at Equilar 100 companies led by women have a higher percentage of female directors than their counterparts. However, the small sample size—pointing to the lack of women in leadership overall—and these other mitigating factors make a definitive statement difficult to prove'.

Likewise, Equilar argues, it's not straightforward to assume that women CEOs earn more than their male counterparts based on the sample. This is due to both the small sample size overall, and the small sample size of women as compared with men — Equilar comments that to get to the eight highest-paid women on the list, you have to go all the way to number 87, whereas you don’t have to leave the top 10 to find the eight highest-paid men — and the fact that the larger the company, the higher the pay.

This demonstrates, Equilar suggests the both the importance of closely investigating the figures, rather than believing the interpretation put upon them without looking more deeply. This is of particular importance, Equilar adds given the level of shareholder engagement 'the rise of shareholder scrutiny and direct engagement on these matters'.

[Source: Women CEOs at Leading Companies: Compensation and Board Diversity Equilar blog 13/04/2018]

Remuneration

On track for a 'tumultuous AGM' at Unilever? ISS has reportedly advised against proposed changes to the pay policy and Glass Lewis has supported it.

The FT writes that Unilever has proposed 'simplifying' its pay policy to incorporate base salary, allowances and pensions into one 'fixed pay' element. According to The FT, if the proposed changes are approved at the upcoming AGM, top executives could potentially receive both larger bonuses and increased fixed pay (eg long-term incentives would be capped at 450% of fixed pay – up from the current 180%). Unilever has reportedly commented that the proposed policy was put forward following consultation with shareholders and is 'simpler, longer term and requires greater personal commitment through share ownership to drive reward'.

According to The FT, Institutional Shareholder Services (ISS) has advised shareholders to vote against the proposed changes: 'Whilst at first glance this alignment and simplification is likely to be welcomed by shareholders, the principal concern raised is that it comes at a price' ISS is quoted as stating.

Reportedly, though Glass Lewis has raised concerns about the proposed changes, it has not advised against them: 'Shareholders should remain mindful of the increased in overall maximum opportunity; however, on balance we believe the proposed policy to be supportable' Glass Lewis is quoted as commenting.

Given this, The FT suggests that the forthcoming AGM may be 'tumultuous'.

The FT adds that the proposed changes are being put forward by the company only one year after shareholders voted to approve significant changes to the policy in 2017 and after CEO Paul Polman was granted a 39% increase in pay for 2017. Reportedly, his total package of €11.7m in 2017 was up from €8.4m the year before. The FT comments that this was the highest amount paid to the chief executive since he assumed the role nine years ago. Mr Polman, who is expected to retire from Unilever within the next 12 months, has championed good corporate governance and responsible business. 'An investor rebellion at possibly his last annual meeting at the consumer goods group is likely to be sensitive for the company' The FT comments.

[Source: [registration required] The FT 14/04/2018]

Markets and Exchanges

In Brief | Goldman Sachs' global head of market structure and head of metals and mining, David Schwimmer has reportedly been appointed the new CEO of the London Stock Exchange replacing Xavier Rolet who ended his eight year tenure in November 2017. Mr Schwimmer will reportedly commence the role on 1 August.

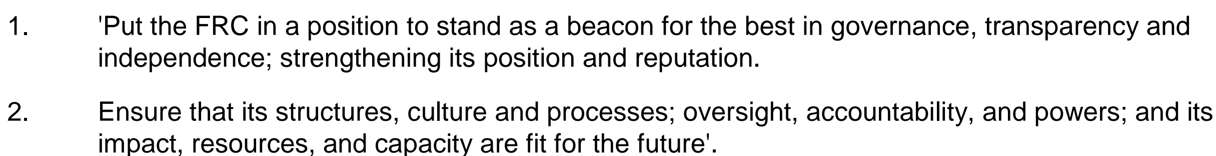
[Source: [registration required] The FT 14/04/2018]

Regulators

Top Story | The UK government have launched a 'root and branch review' of the role and powers of the UK audit regulator, the Financial Reporting Council: The Kingman review of the FRC will review the FRC's governance, impact and powers.

On 17 April, the UK government announced the launch of an independent 'root and branch' review of the Financial Reporting Council (FRC) the regulator for auditors, accountants and actuaries. The review follows calls earlier in the year from Business Secretary Greg Clark among others, for an independent review of the regulator, its independence and its enforcement powers, in the wake of the collapse of Carrillion plc. The purpose of the review according to the government's statement is to 'make the FRC the best in class for corporate governance and transparency, while helping it fulfil its role of safeguarding the UK's leading business environment'.

Key objectives: The review, to be conducted by Sir John Kingman, has been given two objectives:



1. 'Put the FRC in a position to stand as a beacon for the best in governance, transparency and independence; strengthening its position and reputation.
2. Ensure that its structures, culture and processes; oversight, accountability, and powers; and its impact, resources, and capacity are fit for the future'.

The scope of the review includes the FRC's objectives, governance and transparency; its independence (including conflicts of interest); and its impact, resources and capacity. The seven areas of investigation identified in the Terms of Reference are outlined in more detail below.

Timing: According to the Terms of Reference, the review will 'aim' to submit its findings by the end of 2018.

Why is the review happening? The Terms of Reference explain that: 'The FRC and its remit have developed considerably since it was initially established; and it was last the subject of a review in 2011/12. Since then, there have been changes both in regulation, and in expectations of regulators and how they operate. The FRC is a public body. Some stakeholder groups have called for the FRC to demonstrate greater independence from those they regulate. The government's expectation is to see the UK at the forefront of corporate governance internationally, including in terms of regulation. In the context of the UK's exit from the EU, it is even more important that our regulatory structures are fit for the future. With reforms to the UK's Corporate Governance Code in hand, it is also appropriate to make sure that the governance of the FRC as the body with responsibility for the Code, is best in class'.

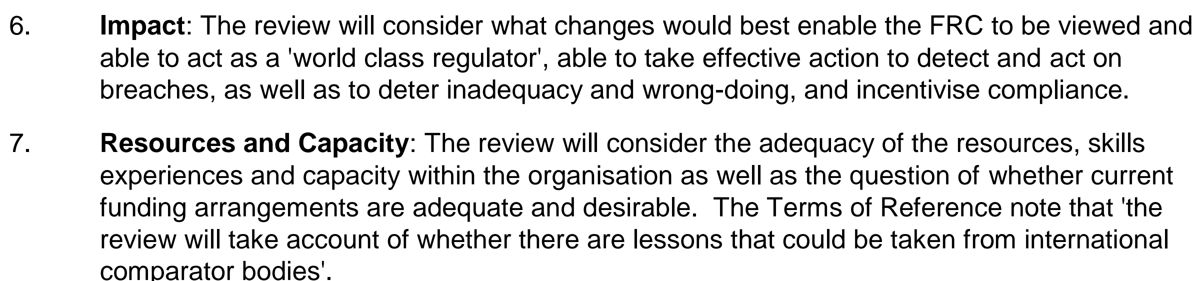
Further detail: Seven areas of inquiry

The Terms of Reference include seven areas of inquiry. These are outlined below.

1. **Governance**: 'The review will consider whether current governance arrangements and their transparency are suitable given the FRC's status as a public body; the increasing span of the its functions (including in relation to large private companies); and in comparison to the increasing expectations on companies, including those that will flow from anticipated changes to the Corporate Governance Code, and especially so as to promote confidence and emulation.'

[Note: Consultation on a proposed new UK Corporate Governance Code closed on 28 February 2018 and the FRC has indicated that it intends to publish a final version of the code by 'early summer 2018'. The new code is intended to apply to accounting periods beginning on or after 1 January 2019. See: Governance News 15/12/2018]

2. **Independence**: The review will consider whether the FRC is sufficiently independent within government and from those it regulates. It will also consider whether current funding arrangements should be revised in this context and/or how any lack of independence might be addressed. The Terms of Reference add that the 'The review will also consider, in particular, whether there are sufficient safeguards in place to ensure and assure that independence. Such measures may include FRC's processes, transparency, culture, or other factors'.
3. **Avoidance of Conflicts of Interest**: The review will consider whether the practices, structure, culture and functioning of the FRCs activities and operations are safeguarded against conflicts of interest, or a perception that there may be conflicts of interest; whether existing mechanisms and practices for the prevention, detection, and resolution of conflicts of interest are adequate, or if additional measures are needed; and whether the procurement of legal and consulting services are suitable.
4. **Oversight and Accountability**: The Terms of Reference state that 'Whilst respecting the FRCs operational independence, the review will consider appropriate mechanisms to realise its accountability to parliament and government'. In addition, it will consider whether current arrangements for the FRC's accountability to stakeholder stakeholders and the public are appropriate, including on the specific matter of Freedom of Information.
5. **Powers**: The review will also consider whether any 'extension of powers is necessary, advisable, or otherwise recommended' and the adequacy of 'the current legal bases for FRC activities'. In addition, it will consider it will consider 'whether there is a case for an underpinning statutory architecture.



6. **Impact**: The review will consider what changes would best enable the FRC to be viewed and able to act as a 'world class regulator', able to take effective action to detect and act on breaches, as well as to deter inadequacy and wrong-doing, and incentivise compliance.

7. **Resources and Capacity**: The review will consider the adequacy of the resources, skills experiences and capacity within the organisation as well as the question of whether current funding arrangements are adequate and desirable. The Terms of Reference note that 'the review will take account of whether there are lessons that could be taken from international comparator bodies'.

Review process:

- The Independent Reviewer will be supported by an Advisory Group that will advise on the direction of the review and sources of evidence and will help to scrutinise and challenge emerging findings and recommendations.
- There will be a small dedicated Review Secretariat acting in support of the Independent Reviewer.
- The Review will undertake engagement with significant stakeholder groups, including those involved in preparing financial accounts, the users of accounts and those affected by other aspects of the FRC's work, including governance and stewardship, in order fully to understand the range of issues, and provide constructive challenge.
- The review process will include a public consultation.
- The final report will be published, and the government will consult on its response to the review's recommendations.
- The FRC released a statement welcoming the review: 'We welcome this independent review of the FRC's governance, impact and powers to be led by Sir John Kingman and look forward to contributing positively to it. Meeting public expectations means using our powers effectively, working closely with other regulators and identifying where gaps in those powers exist. The review will ensure we are best placed to support UK efforts to attract investment in business for the long term.'

[Sources: UK Department for Business Energy and Industrial Strategy media release 17/04/2018; Terms of Reference: Independent Review of the Financial Reporting Council (2018); Financial Reporting Council media release 17/04/2018; Economia 21/03/2018; CityAM 21/03/2018; The Guardian 31/03/2018]

United Kingdom | More engagement with shareholders: The FRC will convene an investor advisory group to act as a formal mechanism for the regulator to regularly engage with stakeholders on risks and areas of concern from a stakeholder perspective.

The Financial Reporting Council (FRC) has released a statement, calling on asset managers, pension funds, sell-side analysts, ratings agencies, proxy advisors and sovereign wealth funds to be representatives of the investor community for a new Investor Advisory Group (IAG).

The FRC states that the IAG will provide a 'regular forum for the FRC to engage with representatives from across the investment chain on various issues, including the FRC's strategy and plan, and new policies and standards on governance, stewardship, reporting and audit matters. It will also help the FRC to better understand the investment community's views of FRC effectiveness'.

The FRC adds that it will use the IAG as a formal mechanism to understand emerging risks and areas of concern, from an investor perspective.

The deadline for nominations for membership of the group is 18 May 2018.

[Source: Financial Reporting Council media release 16/04/2018]

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commencement on the Reserve Bank Board will coincide with the conclusion of Ms Kathryn Fagg's term on 6 May 2018.

[Source: Treasurer Scott Morrison media release 19/04/2018]

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[Source: Treasurer Scott Morrison 17/04/2018]

In Brief | Treasurer Scott Morrison has announced that Mr Mick Keogh OAM will serve as a Deputy Chair of the Australian Competition and Consumer Commission (ACCC) for a period of five years and the reappointments of Ms Sarah Court and Ms Cristina Cifuentes as Commissioners, each for a period of five years.

[Source: Treasurer Scott Morrison media release 19/04/2018]

Corporate Social Responsibility

AICD Director Sentiment Index H1 2018: Sustainability and long-term growth prospects are the key concerns for AICD members

The latest Australian Institute of Company Directors (AICD) Director Sentiment Index (DSI) for H1 2018 was released on 19 April. The DSI is a survey of AICD member opinions and future intentions on a range of issues including the economy, government policy and governance regulations.

Key findings include the following.

What's keeping directors awake at night? Most directors identified sustainability and long-term growth prospects as the main issues keeping them awake at night. The AICD comments that even though the survey was conducted prior to the Cambridge Analytica and Facebook data breach, concern over the issue increased significantly on the last survey.

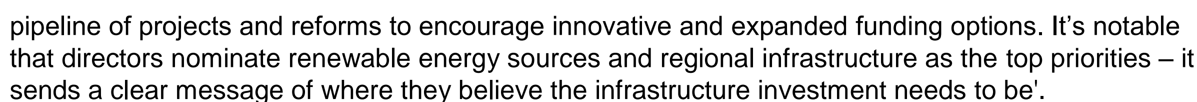
1. Sustainability and long-term growth prospects (40%)
2. Structural change/changing business models (29%)
3. Corporate culture (22%)
4. Business reputation in the community (21%)
5. Data security (21%)
6. Cybercrime (19%)

Support for investment in renewable energy

- 42% of respondents said infrastructure investment needed to be prioritised in the May budget, ahead of controlling government debt (31%) and tax (GST) reform (27%). When asked to list their top 3 priorities for infrastructure investment, directors nominated renewable energy sources (50%), regional infrastructure (42%) and telecommunications infrastructure (38%), particularly the national broadband network (NBN). The AICD comments that only 11% of directors listed investment in nuclear power as a priority, and 10% listed investment in coal power. The AICD observes this is a significant drop in support from an 'already low base'.

[Note: The H2 2017 DSI also identified renewable energy (53%) and regional infrastructure (33%) as top priorities for investment though investment in roads (33% was identified as the third top priority at that time. See: AICD Director Sentiment Index: Second Half 2017.]

- Commenting on the report findings, AICD Managing Director & CEO Angus Armour said they showed that 'Directors want a national focus on infrastructure, including a needs-based forward



pipeline of projects and reforms to encourage innovative and expanded funding options. It's notable that directors nominate renewable energy sources and regional infrastructure as the top priorities – it sends a clear message of where they believe the infrastructure investment needs to be'.

- Three trends most likely to have a positive impact on directors' organisations over the next five years were identified as: 1) big data (67%), 2) increased transparency (60%) and 3) automation (59%).
- The key trend identified as most likely to have a negative impact on organisations over the next five years were: the mass retirement of older workers (37%). The next most negative were: Artificial intelligence (5%); bog data (5%); Automation (5%) Robotics).

Economic Outlook

- Overall, the survey found that directors are more optimistic than at any previous point on record with the director sentiment index reaching 12.7 (an increase of 11.8 points on the last survey) to the highest point since the index began in 2011. More particularly, the survey found that respondents are more optimistic about the Australian economy both now and for the next 12 months than they were in the second half of 2017. Almost half of directors are optimistic about the general business outlook over the coming year, and 51% are optimistic about the outlook for their own sector.
- NSW directors were the most optimistic about their own state's economic health, with 56% of respondents rating the NSW economy over the next 12 months as strong. This was the most favourable result for any state/territory economy, ahead of the ACT and Victoria (both 44%), Western Australia (19%), and Queensland and South Australia (both 17%). Commenting on this, AICD Chief Economist Stephen Walters said 'We can clearly see that nationally, directors are increasingly optimistic about the economic outlook, both for their own sector and the broader economy. They're also more confident in the outlook for the US, Asian and European economies…However, there's a divergence between NSW and Victorian directors and those in other states, particularly in regards to their own state economies. What we're still seeing is evidence of a two-speed economy where the powerhouses of NSW and Victoria are driving the optimism in the national economy.'

Disclosure and reporting:

- Adequacy of public company remuneration reports: 40% of respondents indicated that public company remuneration reports were inadequate with 33% of this group indicating they were 'somewhat inadequate' and 7% indicating they were 'wholly inadequate'.
- Effectiveness of corporate reporting: 48% of respondents indicated corporate reporting is effective. 31% indicated it is wholly ineffective (2%) or somewhat ineffective (29%). A relatively large proportion, almost a quarter of respondents said that they had 'no opinion' 21%.

[Note: According to the AICD, the majority of survey respondents are from private/non-listed entities. 11% of survey respondents are from public companies. Refer to the information under: About the Report below].

Governance

Effectiveness of the current AGM system: 42% of respondents said that the current AGM system is either very dysfunctional 5% or quite dysfunctional (37%) and 27% said it was working quite well (26%) or very well (1%). There was a relatively high proportion of respondents, 31% who said they had 'no opinion'.

Board diversity — skills diversity remains the top priority for boards, followed by gender, age and ethnic diversity:

- Efforts to increase the diversity of skills in board membership was stable in the first half of 2018, with 74% of directors stating that their business is actively seeking to improve in this area. 15% of respondents indicated that skills diversity was 'not relevant' and 11% of boards are either not very actively or not at all actively seeking to improve in this area.
- Gender diversity was the next priority area for boards with 54% of respondents indicating their business is actively trying to increase diversity in terms of gender at board level. Over a quarter of respondents (28%) indicated that this was 'not relevant' and 18% indicated that they were either not actively or not very actively seeking to improve in this area.

- 37% of respondents indicated that they were actively trying to increase diversity in terms of age. Over a third of respondents (34%) indicated that this was 'not relevant'.
- 33% said they were actively trying to increase diversity in terms of ethnicity with nearly a third (32%) this was 'not relevant' and over a third of respondents (35%) indicating that they are either not at all actively or not very actively seeking to improve in this area.

Culture

- The majority of respondents (72%) agreed that there is a risk averse decision making culture on Australian boards. The main reasons for this were identified as: excessive focus on compliance over performance (31%); pressure from shareholders for short term returns (22); lack of genuine diversity in the boardroom (16%); and director liability provisions (14%).
- The top three elements identified by respondents in making changes in corporate culture were: 1) ensuring culture is a regular feature of board and audit committee agenda (53%); 2) Capturing data on key cultural indicators (46%); and 3) communicating the ethical position of the board and business generally (42%).
- The top five steps boards have to take to rebuild trust/regain trust were identified as: 1) Demonstrating respect for customers/clients/communities (46%); 2) improve corporate culture (43%); 3) Trustworthiness of leadership (41%); 4) increased genuine stakeholder engagement (37%) and 5) Greater accountability in cases of misconduct (32%).

Factors influencing director willingness to serve on a board: The survey identified that the majority of directors (88%) identified the contribution they make to the economy and society as the top factor influencing their willingness to serve on a board. This is consistent, the AICD notes with the findings of the previous survey. Remuneration for non-executive directors (26%) was the next most significant factor, followed by time commitment (23%); compliance requirements (11%) and director liability (8%).

Regulation: Directors continue to feel pessimistic regarding the level of ‘red-tape’ in the next 12 months, with 42% expecting an increase. 78% of directors identify corporate reporting requirements as the aspect of their business most affected by ‘red-tape’. This is followed by workplace health/safety and preparing/paying taxes.

About the survey: The Director Sentiment Index (DSI) measures the opinions and future intentions of directors (who are members of the Australian Institute of Company Directors (AICD)) on a range of issues. The latest DSI survey was conducted with 945 AICD members between 8 March and 20 March 2018.

- The majority of respondents were from private/non-listed entities (43%) and not-for-profit entities (33%). The remainder of respondents were from: publicly listed companies (11%); public sector/government bodies (8%) or overseas entities (4%). 1% of respondents declined to specify.
- The majority of respondents identified their primary directorship business sector as health and community services (23%) or Finance and Insurance (16%). The remainder were drawn from a range of other sectors.
- 70% of respondents were male; 30% were female; 0% identified as other or did not specify.
- 69% of respondents were non-executive directors; 35% were executive directors; 34% were chairmen; 9% identified as 'other' and 1% did not specify.
- Most respondents (66%) held 2 or more directorships. Of this group, 38% held three or more. 33% held one directorship. 1% did not specify.
- 3% of respondents were located overseas. Of the remaining 97%, the majority were drawn from NSW (25%) and Victoria (23%) followed by WA (16%); QLD (13%); SA/NT (11%); ACT (6%) and Tasmania (3%).

[Sources: Australian Institute of Company Directors: Director Sentiment Index: research summary first half 2018; Australian Institute of Company Directors: Director Sentiment Index: research findings First Half 2018; Australian Institute of Company Directors media release 19/04/2018; [registration required] The Australian 19/04/2018]

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

Top Story | Financial Services Royal Commission second round of hearings into financial advice: overview of issues arising in relation to fee for no service conduct

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission) commenced its second round of hearings, which will focus on financial advice, on 16 April. During the first week of hearings (16 April to 20 April) the commission heard evidence from a number of entities on the topics of: fee-for-no-service conduct (ie the charging of fees for financial advice that is not provided or not provided in full); investment platform fees and the provision of inappropriate financial advice. The scope of the issues identified during the hearings, was in some instances, not previously publicly known, which has prompted (among other things) a number of former opponents of the commission to alter their stance as to its potential value. A high level overview some of the issues arising in relation to fee-for-no-service conduct is below.

Common themes and questions for the inquiry: The common themes and questions for inquiry identified by Counsel Assisting Rowena Orr QC in her opening statement included:

- Issues concerning 'the adequacy of the current arrangements for disciplining financial advisers. In particular, by examining the ways in which disciplinary matters are currently dealt with in relation to financial advisers, this case study will highlight some of the gaps in the existing system'.
- Whether the misconduct in question is attributable to a particular culture, system or practice within the entity, including, in particular, remuneration, incentive or commission arrangements.
- Why did the misconduct go undetected and, in some instances, for a long period of time?
- Were the entities' processes adequate to prevent and detect misconduct of this nature?
- Did the entity respond in a timely and sufficient way to the misconduct?
- Have the legislative reforms to date been successful in preventing misconduct? If not, why is this the case?

[Source: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 16 April 2018 – Draft Transcript for Day 11]

Fee-for-no-service conduct

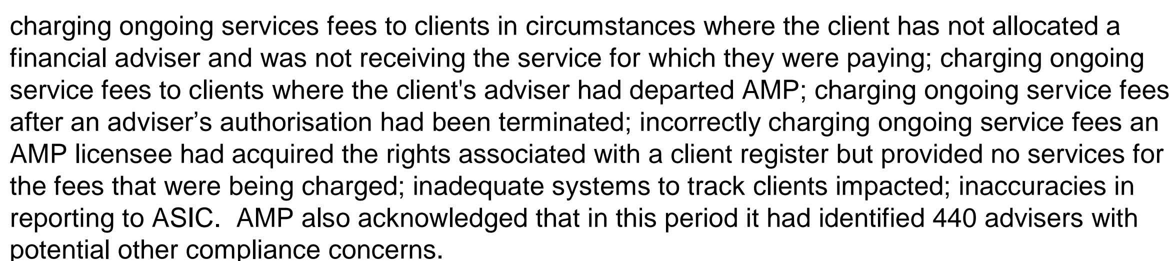
The first case studies on which the Commission heard evidence related to the topic of fee-for-no-service conduct. As per the schedule of topics and case studies published ahead of the hearing, the Commission heard evidence from:

- AMP, AMP Financial Planning Pty Ltd, Charter Financial Planning Ltd and Hillross Financial Services Ltd (AMP) and;
- the CBA, Commonwealth Financial Planning Ltd and Count Financial Planning (CBA).

A brief outline of some of the issues raised by the Commission is below.

AMP Case Study

- *Acknowledgement of various fee-for-no service issues*: Counsel assisting Rowena Orr said that AMP acknowledged in its submissions to the commission that it 'acknowledged 196 events across 14 AMP advice licensees of advisers failing to provide customers with services for which they had paid during 5 the period from 1 July 2008 to 30 June 2015. This resulted in $193,519 being paid to customers in compensation'. In addition, she said, AMP acknowledged six other events which involved an AMP licensee continuing to charge a customer fees for service that were not provided by the licensee or the adviser during the period from 1 July 2008 to 30 June 10 2015. These included:


charging ongoing services fees to clients in circumstances where the client has not allocated a financial adviser and was not receiving the service for which they were paying; charging ongoing service fees to clients where the client's adviser had departed AMP; charging ongoing service fees after an adviser's authorisation had been terminated; incorrectly charging ongoing service fees an AMP licensee had acquired the rights associated with a client register but provided no services for the fees that were being charged; inadequate systems to track clients impacted; inaccuracies in reporting to ASIC. AMP also acknowledged that in this period it had identified 440 advisers with potential other compliance concerns.

- *False and misleading statements to ASIC*: The Commission heard evidence that AMP made false and misleading statements to ASIC regarding ongoing fees-for-no-service policies on 20 occasions. This included representing to ASIC that the business decision to continue charging the fees (when the client was not receiving the service) was an a failure of process rather than a business decision/policy.
- *Influencing an independent report to ASIC regarding the policy to continue charging the fees*? In addition, AMP was questioned over the independence of a report (for ASIC) compiled by Clayton Utz about the Buyer of Last Report policy at AMP and related compliance breaches. In particular, AMP Senior Counsel Assisting Michael Hodge, questioned, given the number of drafts of the report and the alleged involvement of AMP in its preparation, it could be considered independent. Following this evidence the Commissioner stated: 'In view of the evidence given by Mr Regan [AMP's representative], there may be some question about what conclusions, if any, I may reach about the extent to which senior management or others associated with AMP sought to influence or did influence content of the report by Clayton Utz apparently submitted to ASIC as an independent report. It is a matter for AMP and its advisers whether it seeks to have some opportunity to provide any material which goes beyond the evidence given by Mr Regan about that matter, the documents that were tendered in relation to it'.

[Sources: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry transcripts of public hearings: 16 April 2018 – Draft Transcript for Day 11; 17 April 2018 – Draft Transcript for Day 12]

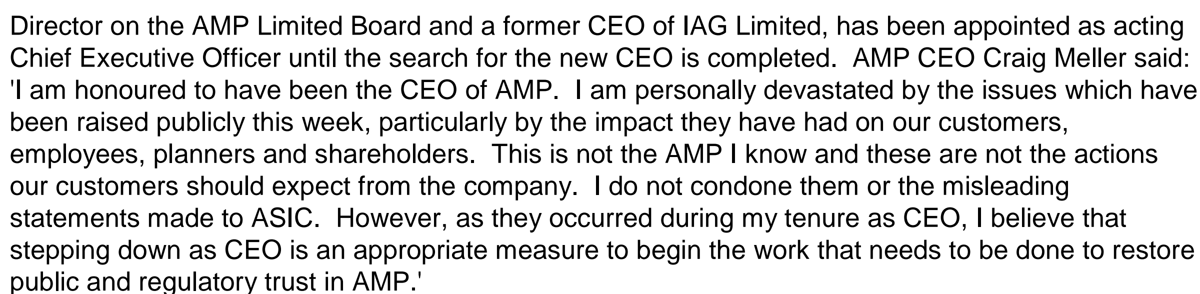
ASIC statement on ongoing investigation into fee for no service conduct at AMP: On 18 April, ASIC issued a statement confirming that it has been investigating AMP's conduct in relation to fees for no service and has, as part of its investigation received 'many thousands of documents and undertaken 18 examinations of AMP staff' and will ensure that compensation is paid to impacted clients. The statement adds that ASIC has been cooperating with the Royal Commission on a range of matters that include both current and previous investigations, reminds financial institutions of the importance of cooperating with the regulator and complying with the law when providing information to ASIC and notes that it will not comment further publicly about the investigation 'at this time'. ASIC's statement followed a statement from the Treasurer confirming that the issues raised were already the subject of investigation by the regulator.

[Source: ASIC statement on AMP 'fees for no service'; Treasurer Scott Morrison Transcript of Doorstop interview, Sydney: Subjects: Labor's retiree tax; IMF's positive outlook for Australia's economy; Financial Services Royal Commission; Budget 2018; GST distribution; Northern Australia Infrastructure Facility 18/04/2018; Interview with Ross greenwood 2GB 18/04/2018]

AMP response: Following the first day of hearings, AMP issued a statement: 'AMP is deeply disappointed that its advice business has charged customers fees where service has not been provided and for misleading the regulator in this regard. We apologise unreservedly.'

AMP issued a further statement on 20 April in which it apologised 'unreservedly for the misconduct and failures in regulatory disclosures in the advice business' and outlining the steps the AMP board will take 'to accelerate the necessary change within the organisation' and build on the existing program of work, commenced in 2017.

- These additional actions include: a comprehensive review of AMP's regulatory reporting and governance processes to be overseen by an independent expert and the review, by a board committee, of the issues related to the advice issued raised at the Commission.
- In addition, the statement announced that AMP CEO Craig Meller would step down from his role with immediate effect. The statement added that the board would withdraw a resolution relating to an equity grant for the CEO from its Notice of Meeting to the 2018 AGM. Mike Wilkins, a Non-Executive



Director on the AMP Limited Board and a former CEO of IAG Limited, has been appointed as acting Chief Executive Officer until the search for the new CEO is completed. AMP CEO Craig Meller said: 'I am honoured to have been the CEO of AMP. I am personally devastated by the issues which have been raised publicly this week, particularly by the impact they have had on our customers, employees, planners and shareholders. This is not the AMP I know and these are not the actions our customers should expect from the company. I do not condone them or the misleading statements made to ASIC. However, as they occurred during my tenure as CEO, I believe that stepping down as CEO is an appropriate measure to begin the work that needs to be done to restore public and regulatory trust in AMP.'

- The statement also said that AMP Group General Counsel Brian Salter will take leave during the independent review. David Cullen, AMP General Counsel, Governance has been appointed as acting Group General Counsel.
- AMP also said that it will be making a submission to the Royal Commission to respond to the issues raised. The submission will, among other matters, address the issue of the independence of the Clayton Utz report.

[Source: The Guardian 17/04/2018; [registration required] The AFR 17/04/2018]

CBA Case Study

- Counsel Assisting Rowena Orr said that CBA had acknowledged misconduct and conduct falling below community standards and expectations in relation to the provision of financial advice including in relation to fees for no service. Examples cited by Ms Orr included (among others): charging Commonwealth Financial Planning, BW Financial Advice and Count Financial clients for ongoing advice where no financial advice services were provided and the failure to provide or failure to locate evidence regarding the provision of annual reviews (which was the subject of the Enforceable Undertaking entered into with ASIC) among others.
- The Commission heard evidence that CBA had charged clients more fees for no services than any other entity. Questions were asked by the Commission regarding a number of issues in relation to this including: the alleged lack of action by the CBA in respect of the deduction of fees by entities under CBA management from client accounts eg in circumstances where the client was known to have died; the ability of the organisation to identify and report on the breaches given the lack of systems in place to do so; when the CBA became aware of alleged breaches/the time taken to report breaches to ASIC and the number of financial planners available to service client's needs. Questions were also asked regarding the CBA's assessment of the scope of the alleged breaches.

[Sources: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry transcripts of public hearings: 17 April 2018 – Draft Transcript for Day 12; 18 April 2018 – Draft Transcript for Day 13; 19 April 2018 – Draft Transcript for Day 14]

Context

- The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission) second round of hearings will run from 16 April to 27 April.
- The hearings will consider 'the conduct of financial services entities that provide financial advice to consumers, including the treatment of consumers, compliance with the law and community standards and expectations, and the sufficiency of the current legal and regulatory structure' the Commission writes.
- As per the schedule of topics and case studies released prior the hearings, the hearings will proceed by reference to case studies on five topics. These case studies involve: AMP, CBA, Westpac, ANZ, NAB and some other major financial planning groups.
- The Commission is expected to provide an interim report to the Governor-General by 30 September 2018, with a final report due by 1 February 2019.

[Source: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Round 2 hearings]

Background papers: The Commission has released two background papers on the legal framework for providing financial advice ahead of the hearings to assist in informing proceedings. These are:

- Background Paper 6 (Part A):Some Features of the Australian Financial Planning Industry;
  Background Paper 6 (Part B): Education and Training Requirements for Financial Advisers;
  Background Paper 6 (Part C): Financial Products Available to Retail Investors, Background;
- Paper 7: Legal Framework for the Provision of Financial Advice and Sale of Financial Products to Australian Households and a further paper, prepared by Treasury: Background Paper
- 8: Key Reforms in the regulation of financial advice, on the key reforms in the regulation of financial advice.

ASIC Deputy Chair Peter Kell comments on fees-for-no-service conduct, conflicted remuneration and inappropriate advice to establish self-managed superannuation funds (SMSFs).

The key points of Australian Securities and Investments Commission (ASIC) Deputy Chair, Peter Kell's evidence to the Financial Services Royal Commission is below.

Inappropriate advice generally and inappropriate advice to establish self-managed superannuation funds (SMSFs).

In relation to inappropriate advice, Mr Kell said that ASIC has found that both large and small Australian Financial Services (AFS) licensees are 'struggling to get to grips with how best to implement the key best interests duty requirements', including how they are documented in advice files. Referencing a recent review of large vertically integrated firms, Mr Kell said ASIC had found that around 75% of the files examined did not demonstrate compliance with the best interest duty and related obligations.

[Note: The findings Mr Kell is quoting are drawn from ASIC Report 562 *Financial advice: Vertically integrated institutions and conflicts of interest*. See: Governance News 29/01/2018]

90% of advisers don't comply with best interests duty? Mr Kell stated that ASIC had recently conducted a survey of advice around establishing self-managed super funds (which has not yet been released publicly) which found that 9 in 10 client files did not demonstrate compliance with the best interests duty and other associated obligations under the Corporations Act 2001. Mr Kell added that the principal causes of inappropriate advice were/are that 'Conflicts of interest that are not either avoided or appropriately managed'.

Mr Kell also noted that the majority of instances did not involve consumer detriment.

More needs to be done on 'conflicted remuneration reforms': When asked to comment on the success or otherwise of conflicted remuneration reforms, Mr Kell said that it was 'not necessarily straightforward to assess the impact of the conflicted remuneration reforms when you consider that there have been a lot of other reforms coming in at around the same time'. He added that concerns remained, for ASIC around 'vertically integrated businesses' which he said 'have an inherent conflict…There is inherently a conflict between manufacturing a product and supplying a product but then having advice network or advisers who are supposed to be providing advice in the best interests of the clients, putting the clients – or prioritising the interests of the clients, so doing both within the same firm is allowed under the regime, but it does produce a conflict that needs to be appropriately managed'.

Similarities between ongoing service fees and the Commissions that financial advisers used to receive prior to the FOFA reforms? Mr Kell suggested that in ASIC's view 'if ongoing service fees are improperly applied, then they do, unfortunately, have some similarities with some of the more problematic aspects of Commissions, being that they are recurring, they can be invisible to the customer from a practical point of view, and – and there may be no clarity around what exactly the customer is getting or supposed to get in – in return for – for these payments. If properly applied, it can be different, but if improperly applied – and that's happened on a widespread scale – they do have some distinct similarities.'

The need to increase standards of professionalism in the sector

Financial advice is 'not yet a profession': Asked whether the financial advice industry in Australia is a profession, Mr Kell stated that 'In ASICs view, it is not yet a profession. There are certainly professionals

within the industry, but we do not view the industry as a whole as having reached what would normally be regarded as the standards of a profession at this point in time, and it's – I think you could say it's the objective of the regulator but also most of the industry participants and others, that we move to a profession. It's one of the reasons why the government has recently introduced reforms aimed at raising professional standards for the industry'. When asked why this is the case Mr Kell identified that the standards around competency and qualifications needed; remuneration practices and associated conflicts of interest and 'some of the conduct and consumer outcomes that have been very poor on a widespread scale, indicate that we're not yet at a position where we have a profession. I would also note that we don't have in this sector a single, if you like, dominant professional association. There are some associations which have taken a more forward looking approach to standards, but we certainly don't have a professional association of the sort that you get in other sectors such as medicine'.

Separately, the ABC reports that this view is shared by former Labor MP Bernie Rippoll (who chaired the 2009 'Rippoll inquiry' into financial products and services which led to the Future of Financial Advice (FOFA) reforms) expressed a similar view to Mr Kell stating that after ten years of reform 'Financial planning doesn't have professional standards, a code of conduct, defined educational standards and the commitment to a fiduciary type duty to customers that real professions have.'

[Source: The ABC 17/04/2018]

Fee-for-no-service conduct

- **The majority of fee-for-no-service conduct falls into the category of 'selling what you don't deliver':** Commissioner Kenneth Hayne suggested to Mr Kell that fee-for-no-service conduct could be said to fall broadly into three categories: 'selling what you can't deliver, selling what you won't deliver and selling what you don't deliver.' Asked to be specific as to which he considered the category the majority of cases fall into, Mr Kell said 'I would say in this instance the "don't deliver" would characterise the majority of the cases that we're talking about, with some of – it would appear some of the "can't deliver" perhaps being mixed in there as well, but this – this issue is one where I think there is more of a – a service where you don't deliver, rather than won't'. Commissioner Hayne commented that 'Selling what you can't deliver might raise issues about application of the law that are rather different from either of the other two categories, I would have thought, but those are matters that perhaps we will look at'.
- **Mr Kell identified the cause of fee-for-no-service conduct as the fact that the major financial advice firms had 'prioritised fee revenue from their advice businesses over the provision of services to the clients'.** Mr Kell added that:
  - The 'systems that underpinned the ability to collect revenue were better developed than the systems that ensured that the client received the advice'.
  - Systems for tracking whether advice had been provided were characterised by Mr Kell as 'poor'. Consequently, he said that the record keeping and systems for tracking whether the advice had been provided were 'poor' which meant that for many of these entities it was difficult to identify how widespread the problem was, and how long had it been running for.

ASIC has met resistance from financial services entities or their representatives in remediating customers charged fees for no service: Asked whether ASIC had met resistance from financial service entities or their representatives in remediating customers charges fees for no service Mr Kell answered in the affirmative. Mr Kell said 'This – this has been, at times, quite a difficult process around two issues in particular. One is the remediation programs, and the second is around the nature of the reviews that are required to establish whether there has been further charging of fees for no service. So we've ended up having, at times, reasonably vigorous debates around the scope of – of the reviews and how many licensees should be included'.

ASIC's enforcement powers are limited: Commenting on the avenues currently available to ASIC to take action to address the issue, Mr Kell said: 'We do not have at this point in time a straightforward ability to require a remediation program of the sort that we think is – is, in many cases, desirable'.

[Source: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 16 April 2018 – Draft Transcript for Day 11]

Calls for stronger regulation? The SMH reports that there have been calls for stronger regulation of the sector. The article quotes Professor Ian Ramsay as expressing the view that ASIC needs access to stronger penalties and needed to apply them more readily, rather than relying on banning financial advisers: 'At the end of the day, the strongest enforcement message is to do something more than just banning people.'

[Source: The SMH 17/04/2018]

Financial Services Royal Commission second round of hearings into financial advice: overview of issues arising in relation to the provision of inappropriate financial advice.

The second set of case studies on which the Commission heard evidence related to the topic of inappropriate advice. As per the schedule of topics and case studies published ahead of the hearing, the Commission heard evidence from:

- Westpac and BT Financial Group; and
- ANZ, RI Advice Group Pty Ltd and Millennium 3 Financial Services Pty Ltd.

In addition, the Commission heard evidence from Jaqueline McDowall regarding advice in relation to advice received in relation to her (and her husband's) retirement plan.

[Note: At time of writing, the Commission is still hearing evidence from ANZ. On this basis, this post deals with issues arising in relation to the Westpac case study only.]

Westpac case study: Counsel Assisting, Rowena Orr QC said that Westpac acknowledged in submissions that it had engaged in misconduct or conduct falling below community standards and expectations in connection with the provision of financial advice including misconduct in relation to fees for no service and gave a number of examples of this drawn from Westpac's submission.

The Commission also heard evidence from a former Westpac client, Jacqueline McDowall regarding the provision of inappropriate retirement advice. In this case, Ms McDowall (a nurse of 30 years experience) and her husband (a truck driver) wanted to retire and purchase a bed and breakfast business. They were told by their financial adviser that this was feasible and given a strategy that included: selling their family home; rolling their $200,000 in superannuation into an SMSF and taking out substantial Westpac insurance. Having sold their home, the Commission heard that they received advice that they were ineligible to borrow the money necessary to execute their retirement plan.

The Financial Ombudsman Service subsequently found that the advice was inappropriate for the couple's circumstances and that the couple would not have embarked on the retirement strategy had they not received the advice. It directed Westpac to compensate the couple for their financial losses.

The Commission heard evidence from Westpac that the adviser who provided the advice to Ms MacDowell is still employed by Westpac as a senior financial planner and remains eligible for bonuses for the provision of advice, though he was referred to ASIC (upon ASIC's request) in 2015 in response to a requires for information about advisers whose conduct had given rise to concerns.

Westpac conceded that the advice given in this instance was 'poor' and that the accountability mechanisms ('consequence management program') were inadequate.

Westpac was also questioned (among other things) on what internal policies were in place to ensure advisers complied with their duty to act in the best interest of their clients; the effectiveness of those policies; whether there were and are sufficient accountability mechanisms in place for advisers.

[Source: 19 April 2018 – Draft Transcript for Day 14]

Opening Statement | Counsel Assisting's opening address to the Commission

Below is a brief overview of the key points of Counsel Assisting, Rowena Orr QC's opening statement to the Royal Commission.

1. **Outlined the key features of the financial advice industry**. In particular Ms Orr noted that:

- There has been rapid growth, an increase of 41% in the number of financial advisers, in the industry since 2009.
- The industry is 'highly concentrated' with the four major banks and AMP collectively holding 48% market share (by industry revenue) and 44% of advisers, both aligned and non-aligned, operating under a licence controlled by the largest 10 financial institutions.
- Educational standards are not currently uniform across the advice sector: Of the approximately 25,000 financial advisers registered in Australia, 8704 have told ASIC that they have completed a degree at bachelor level or above, representing 35 per cent of all advisers.

2. **Described two recent examples of issues in the industry**: Storm Financial and Commonwealth Financial Planning Limited.
3. **Provided an overview of the key features of the legal framework governing the provision of financial advice** and the 'considerable reform' it has been subject to in recent years and is in the process of undergoing (eg the implementation of Future of Financial Advice reforms; the implementation of compulsory education requirements among others). Ms Orr noted that the hearings will invite consideration of whether the reforms that have been made to date have achieved their intended purpose. Ms Orr said in the relation to the current regime: 'The regime originally created by this Act has since been extensively refined and reformed with the result that it is now highly detailed, complex and specific. It has been described by some as obscure and convoluted'.
4. **Summarised what consumers have told the Commission** about their experiences with financial advice through public submissions submitted via the Commission's online portal. Issues highlighted in the submissions included (among others):
   - Instances of being charged fees for no service by financial advisers, including continuation of fees for ceased services, fees for premium services that were not received, and fees for advice that has not taken the clients' needs into account.
   - Instances of financial advisers providing advice encouraging clients to engage in lending they are not capable of servicing over the long term.
   - Inappropriate advice in relation to investing savings and funds borrowed against private property where the customer has requested conservative or low-risk investments.
   - Instances where clients were led (by their adviser) to invest in high-risk investment schemes that were inappropriate for their individual circumstances, which has caused substantial losses over short periods of time.
   - Instances of customers being pressured by advisers to consolidate or roll over their existing superannuation into an in-house superannuation product.
   - Concerns about actual or perceived conflicts of interest between their financial adviser and a financial services entity.
   - Concerns about a lack of transparency in relation to the financial adviser's role and their remuneration arrangements with a particular financial entity.
   - Concerns that financial advisers are often only recommending particular in-house or Commissioned products.
5. **Summarised some of the regulatory outcomes** obtained in recent years in respect of misconduct in the financial advice industry. Ms Orr said that ASIC has told the Commission that:
   - Since 1 January 2008, ASIC is aware of $383.117 million of compensation being paid to clients who have suffered financial loss as a result of the provision of financial advice, or as a result of a failure to provide ongoing services as part of an arrangement to receive financial advice.

- ASIC has told the Commission that as at 28 February this year, approximately 305,946 customers have been paid or agreed to be paid a total of $216.421 million by five entities in compensation as a result of fees paid for no service. Of this total amount:
  - 117.8 million has been paid by CBA;
  - 49.314 million has been paid by ANZ;
  - 41.313 million has been paid by NAB;
  - 4.715 million has been paid by AMP; and
  - 3.276 million has been paid by Westpac.
- Ms Orr noted that each of the entities estimate that they will pay further compensation yet with the total compensation that will be paid to customers across these five entities being estimated at approximately $218.939 million. Across these entities, more than 310,000 customers have been affected, with a number of the entities still considering the total number of affected customers.
- ASIC has also told the Commission that since 1 January 2008 in respect of authorised representatives, employees of licensed entities, or other individuals providing financial services, it has obtained 60 enforceable undertakings and 39 negotiated outcomes; cancelled 116 financial services licences, and suspended 27 more; imposed additional licence conditions on 18 licensees; obtained banning orders against 387 individuals; issued 14 infringement notices for misconduct imposing penalties totalling $149,000; commenced 12 civil penalty proceedings which have led to the imposition of penalties totalling $23.64 million; and commenced 50 criminal proceedings.

6. **Outlined what the two external dispute resolution bodies** who deal with disputes relating to the provision of financial advice (the Financial Ombudsman Service) and the (Credit and Investments Ombudsman) have told the Commission.

7. **Outlined the roles of the two key industry bodies, being the Financial Planners Association and the Association of Financial Advisers**: Of the 626 disputes about advice accepted by FOS in 2016-17 around half were in relation to a financial adviser. The most common complaints to FOS in relation to financial advisers concerned inappropriate advice and failures to follow customer instructions. The Credit and Investments Ombudsman told the Commission that of the complaints it received about financial advisers the largest proportion was about inappropriate advice, around 39 per cent. Followed by excessive or incorrectly charged fees, 28 per cent of complaints, conflict of interest, around 15 per cent of complaints, and failure to follow a customer's instructions, around 11 per cent of complaints.

8. **Summarised what financial services entities** have acknowledged to the Commission as their own and their related entities misconduct, and conduct that has fallen below community standards and expectations.

9. **Provided an overview of the nature of the evidence** that will be heard during the second round of headings and an outline of the case studies that the Commission will be considering and why these case studies have been chosen. More particularly, Ms Orr indicated that the hearings would focus on the following:

- the charging of fees for financial advice that is not provided or not provided in full (fee-for-no-service) the provision of inappropriate financial advice;
- instances of improper conduct by financial advisers, including misappropriation of customer funds;
- the sufficiency of the disciplinary and regulatory regime for dealing with misconduct by financial advisers.

[Source: 16 April 2018 – Draft Transcript for Day 11 [PDF 513KB]

Too big to manage conflicts effectively? Reportedly, former Australian Competition and Consumer Commission chairman Allan Fels has said that forcing banks to sell off their financial planning businesses should be considered.

The SMH reports that former Australian Competition and Consumer Commission (ACCC) Chair Allan Fels has said, in the wake of recent hearings before the Financial Services Royal Commission, that it was apparent that conflicts of interest within bank-owned financial advice networks were unmanageable and that they were leading to poor customer outcomes'. He reportedly added that in his opinion, the Commission 'needs to look at structural separation as a possible remedy' on the basis that it is 'usually far more effective than trying to regulate the behaviour of banks' the article quotes Mr Fels as saying. Reportedly, Mr Fels was also critical of the Australian Securities and Investments Commission's (ASIC's) approach, 'It needs to exercise its powers more vigorously, with more court action and fewer undertakings…They have not had a long-term culture of vigorous law enforcement. They have improved but they've still got quite a long way to go.'

According to The SMH, Kevin Davis (a member of the 2014 financial system inquiry panel and currently research director at the Australian Centre for Financial Studies), suggested that the Commission might recommend putting limits on the types of financial services businesses that could be owned by a single corporation and consider caps on 'vertical integration'. Mr Davis reportedly described such restrictions as a 'big step' and added that he was not necessarily supportive of such a change.

[Source: The SMH 18/04/2018]

More time? The Government is reportedly open to extending the twelve month time frame for the Commission to complete its investigations.

The AFR reports that Finance Minister Mathias Cormann has said that the government is willing to allow the Commission more time to complete its investigation if required: 'I mean if the Royal Commissioner says to us that there is more work to be done, that he needs more time, then obviously the government would act on that' Mr Cormann is quoted as saying.

Currently the reporting deadline for the Commission in February 2019.

[Source: [registration required] The AFR 19/04/2018]

Other Developments

Government response to ASIC Enforcement Review Recommendations released: 'the most significant increases to the maximum civil penalties, in some instances, in more than twenty years' according to Minister for Revenue and Financial Services Kelly O'Dwyer.

On 19 October 2016, the government announced a taskforce to review the Australian Securities and Investments Commission's (ASIC's) enforcement regime. The Taskforce report, which included 50 recommendations, was provided to the Government in December 2017 and released publicly in conjunction with the government response on 20 April. The Report makes recommendations to improve ASIC's ability to gather information, strengthen ASIC's licensing and banning powers, increase civil and criminal penalties for corporate misconduct and encourage greater use of industry codes of conduct.

The government agrees, or agrees in principle, to all Taskforce recommendations. Minister for Revenue and Financial Services Kelly O'Dwyer describes the reforms as the 'most significant increases to the maximum civil penalties, in some instances, in more than twenty years. They bring Australia's penalties into closer alignment with leading international jurisdictions, and ensure our penalties are a credible deterrent to unacceptable misconduct'.

Taskforce recommendations

In its report, the Taskforce made 50 recommendations in relation to the following eight areas.

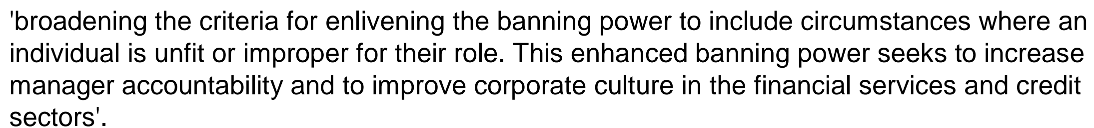
1. **Strengthening penalties for corporate and financial sector misconduct:**

- **Expand the range of civil penalty provisions and to increase the maximum penalty amounts** in the *Corporations Act 2001* and *National Consumer Credit Protection Act 2009* (Credit Act) substantially:

- for individuals penalties would increase to 2,500 penalty units ($525,000); and
- for corporations penalties would increase to the greater of 50,000 penalty units (currently $10.5 million) or three times the value of benefits obtained or losses avoided or 10% of annual turnover in the 12 months preceding the contravening conduct (but not more than 1 million penalty units ($210 million)).

- **ASIC would be able to seek disgorgement** remedies (removal of benefits illegally obtained or losses avoided) in civil penalty proceedings brought under the Corporations, Credit and ASIC Acts.
- **Criminal penalties would also be increased for a range of offences**. The most serious Corporations Act offences, given the nature and/or consequences of the offending conduct (many involving dishonesty) would become equivalent to the highest penalties currently available under the Act:
- For individuals: This would mean 10 years imprisonment, 4,500 penalty units ($945,000) or 3 times benefits.
- For corporations: This would mean 45,000 penalty units ($9.45 million) or 3 times benefits or 10% annual turnover.
- **Maximum fine amounts for other criminal offences would also increase**, and be standardised by reference to a formula based on length of available prison term: maximum term of imprisonment in months multiplied by 10 = penalty units for individuals, multiplied by a further 10 for corporations.
- **For strict liability offences, the lowest level fines would increase** and ASIC would be able to deal with these offences through the existing penalty notice regime as an alternative to prosecution.
- **ASIC would also be able to deal with a wider range of offences through infringement notice regimes.**

2. **Harmonisation and Enhancement of Search Warrant Powers:** The report recommends that '*Australian Securities and Investments Commission Act* 2001 (ASIC Act) search warrants in various Acts should be consolidated into the ASIC Act and ASIC's powers will be more consistent with those in the Crimes Act and the Competition and Consumer Act. Material seized under ASIC Act search warrants should also be available for use in criminal, civil and administrative proceedings (ensuring that ASIC is not unduly constrained from using material seized pursuant to its search warrant powers)'.
3. **ASIC's access to telecommunications intercept material:** The report notes that currently ASIC is unable to seek a warrant to obtain or receive intercept material when investigating serious contraventions of the *Corporations Act 2001* (Corporations Act) unless another agency is authorised to share such material with ASIC for the purpose of its investigations. To address this issue, the report 'recommends that ASIC should be able to receive telephone intercept material to investigate and prosecute serious offences'.
4. **Strengthening ASIC's licencing powers**: To ensure ASIC can refuse to grant a licence and (for existing licenses) is able to suspend or cancel a licence where appropriate, the report recommends: the implementation of a fit and proper test for new licensees; the creation of a statutory obligation to notify ASIC about changes of control; and alignment between the process for assessing credit licences and financial service licences.
5. **ASIC's power to ban individuals in the financial sector:** The report recommends enabling ASIC to ban individuals from managing financial services businesses in addition to their current power to ban individuals from providing financial services. In addition, the report recommends


'broadening the criteria for enlivening the banning power to include circumstances where an individual is unfit or improper for their role. This enhanced banning power seeks to increase manager accountability and to improve corporate culture in the financial services and credit sectors'.

6. **ASIC's directions powers**. The report recommends strengthening ASIC's power to require compliance with AFS or credit licence obligations 'in real time, and that the regulator should be given powers to direct licensees to take or refrain from taking actions where appropriate for this purpose, subject to procedural fairness'.

7. **Self-reporting of contraventions by financial services and credit licensees**: The report states that the 'Taskforce considers that financial services and credit licensees should be required to report significant breaches to ASIC'. The report recommends that the 'significance test' be retained but 'clarified to ensure that the significance of breaches is determined objectively'. The report adds that the time for reporting would be extended from 10 to 30 days, but licensees would be required to make a report if they are investigating a breach and have not yet determined within 30 days whether it meets the significance threshold. The report states that 'failures to report, objectively determined as such, can be more effectively sanctioned and increasing the incidence of reports, by requiring a report to be made within 30 days, even if a breach investigation has not been finalised'.

8. **Industry codes in the financial sector**: The report recommends 'shifting to a co-regulatory model' to enhance ASIC's ability to enforce codes in the financial sector. 'Under a co-regulatory model, industry participants would be required to subscribe to an ASIC approved code, and in the event of non-compliance with the code an individual customer would be entitled to seek appropriate redress through the participant's internal and external dispute resolution arrangements. This model would operate only in sectors where ASIC considered its application appropriate having regard to all the circumstances'.

Government response

- The government agrees, or agrees in principles with all Taskforce recommendations.
- Minister for Revenue and Financial Services Kelly O'Dwyer said that the government will prioritise 30 recommendations relating to enhanced penalties and strengthened powers for ASIC (in areas 1 to 5 above).
- Ms O'Dwyer said that the remaining recommendations relating to self-reporting of breaches, industry codes and ASIC's directions powers will be considered alongside the final report from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

Minister O'Dwyer stated: the 'Government is committed to ensuring ASIC is armed with greater powers to effectively deter, prosecute, and punish those who do the wrong thing, to improve community confidence and outcomes for consumers and investors in the financial services and corporate sector. These reforms come on top of strong Government action to reform our financial services sector to better protect Australian consumers over a number of years'.

[Sources: Minister for Revenue and Financial Services Kelly O'Dwyer media release 20/04/2018; Australian Government response to the ASIC Enforcement Review Taskforce Report; Taskforce report]

The Australian Banking Association said: 'A stronger range of penalties for misconduct is vital to tackling criminal and unacceptable behaviour by individuals and corporations. The industry has supported the strengthening of the penalties regime for misconduct since the Federal Government announced its review 18 months ago, as an outcome of the Financial Services Inquiry. Australia's banks are committed to tackling misconduct head-on and strongly back the reforms proposed today by the Turnbull Government to penalise bad conduct within the industry'.

The statement goes on to say that before the announcement banks were already acting on the need for change eg by putting in place background checks on bank employees to prevent those with a history of misconduct from moving between institutions and adding that industry expects that further changes should and will be made following the recommendations of the Commission.

[Source: Australian Banking Association media release 20/04/2018]

Draft regulations to improve ASIC's powers to enforce Client Money Reporting Rules 2017 released for consultation.

Treasury has released draft *Corporations Amendment (Client Money Reporting Rules Enforcement Powers) Regulations 2018* for consultation. Minister for Revenue and Financial Services, Kelly O'Dwyer said that the draft regulations were designed 'support and improve the powers of the Australian Securities and Investments Commission (ASIC) to enforce the new client money regime which commenced on 4 April 2018' and more particularly that the draft regulations would improve ASIC's powers to enforce the Client Money Reporting Rules 2017 (the Rules).

Currently, the *Corporations Act 2001* allows ASIC to impose a pecuniary penalty of up to $1 million for non-compliance with the ASIC Rules.

The draft Regulations propose to give ASIC alternatives to civil proceedings: namely, the ability to issue infringement notices and enter into enforceable undertakings with licensees.

Treasury states that the 'resulting regime will effectively mirror those already operating to enforce ASIC's market integrity, derivative transaction and trade reporting rules'.

Consultation will close on 26 April.

[Sources: Treasury media release 17/04/2018; Exposure Draft: Corporations Amendment (Client Money Reporting Rules Enforcement Powers) Regulations 2018; Draft explanatory statement; Minister for Revenue and Financial Services Kelly O'Dwyer media release 17/04/2018]

Final McPhee report released; Industry has adopted recommendation to continue to report on progress.

The final report for the Australian Banking Association, prepared by Ian McPhee AO PSM, into progress towards implementing the banking reform program Commissioned in April 2016, was released on 17 April.

Progress: The report found that since the announcement of the initiatives to improve customers outcomes, banks have reported that the industry-led work for 11 of the 13 planned measures has been completed, with three of those 11 measures still dependent on statutory underpinnings for finalisation. The two measures where industry-led work is continuing relate to:

implementation of individual bank policies on remuneration and incentives to adopt the Sedgwick Review recommendations; and

changes to bank processes to reflect changes required by the new Banking Code of Practice.

Changes most likely to have significant impact on the bank-customer relationship: The report identifies the following as the areas most likely to have significant impact on the bank-customer relationship:

The removal of, or amendment to, sales Commissions and product based payments, to strengthen alignment to customer outcomes;

The substantial revision to the Code of Banking Practice to ensure the Code adequately covers the expected standards of good banking practice when dealing with individual and small business customers and, when applicable, their guarantors; and

The establishment of dedicated customer advocates to give individual retail and small business customers a stronger voice, and facilitate the more efficient resolution of issues for these customers.

Full implementation will take a further 2-3 years: The report states that the implementation period for individual banks is expected to take a further two to three years due to the changes required to bank policies and systems, training requirements and the need to engage with employees and other stakeholders as appropriate. Recommendation to provide regular updates on progress to the public.

Recommendation to provide updates on progress adopted by industry: The report makes one recommendation, which was accepted by the ABA (on behalf of the Banking Industry) namely that the industry 'commit to the development and introduction of a policy which would provide for individual banks to

publish appropriate performance indicators and commentary to give greater transparency to their success in achieving the industry’s goals of building trust and confidence'.   The report adds that in addition, the industry has committed to: In addition, the industry has committed to 'finalise measures of effectiveness of the customer advocate function; and to continue to work with the Combined Industry Forum (CIF) to reach a position on conflicted remuneration structures, in order for the participating banks to implement the Sedgwick Review recommendations by the 2020 deadline'.

[Source: Ian McPhee AO PSM Independent governance expert report Australian banking industry: Package of initiatives Report 8 17/04/2018]

The Australian Banking Association has issued a statement welcoming the release of the report, highlighting the initiatives already implemented, confirming that banks are on track to meet the 2020 deadline for full implementation of the Sedgwick Review recommendations and confirming the adoption of the report recommendation. ABA CEO Anna Bligh is quoted as stating: 'The industry has set a cracking pace on some of the toughest reforms in over a decade, as detailed in Mr McPhee’s final report, however there is still further work to be done to bed these down. Banks have made a large investment in reform to better meet community expectations, such as changing the way bank staff are paid and improving customer protections under the new Banking Code. Banks are on track to meet the 2020 deadline set by the Sedgwick Review to reform the way they pay their staff including abolishing direct sales incentives and scrapping mortgage broker Commissions directly linked to loan size. While this is the final report by Ian McPhee the industry has taken his advice and will be putting in place further arrangements for public reporting. Banks will be making further regular public reports on the success of the program and their ongoing implementation of the Sedgwick recommendations and the new Banking Code'.

[Source: Australian Banking Association media release 17/04/2018]

Increasing competition? Exposure Draft legislation proposes to relax ownership restrictions of banks and insurers: *Financial Sector (Shareholdings) Amendment (Relaxing Ownership Restrictions) Bill* 2018.

Treasury has released an exposure draft of the *Financial Sector (Shareholdings) Amendment (Relaxing Ownership Restrictions) Bill* 2018 and related explanatory statement for consultation.

The draft Bill proposes to:

- *Relax the restriction on ownership of banks and insurers:* The draft Bill proposes to increase the ownership restriction applying broadly to banks, credit unions and building societies, and relevant holding companies under the *Financial Sector (Shareholdings) Act 1998* (FSSA) from 15% to 20%. The Treasurer comments that this is 'in line with' Foreign Acquisitions and Takeovers Act 1975 requirements.
- *Create a new 'streamlined approval path'* under the FSSA for owners of domestically incorporated companies applying to become a new financial sector company (or those proposing to acquire shares in entities licensed by the Australian Prudential Regulation Authority (APRA) for fewer than five years). These owners may be eligible to receive streamlined approval to hold a stake of more than 20% where certain criteria are met. These criteria include a fit and proper assessment of the prospective owners and maximum asset holdings of the entity sought to be acquired.
    - ADI/Life Insurer applications: if applying to become an authorised deposit-taking institution (ADI) or a life insurer, or licensed as such for fewer than five years, the entity has assets of less than $200 million; or
    - General Insurance Company applications: if applying to become a general insurance company, or licensed as such for fewer than five years, the entity has assets of less than $50 million.

'Removing perceived barriers to entry in the sector should encourage greater start-up activity with the intention of increasing competition and offering consumers more choice in this critical part of the Australian economy' the explanatory memorandum states.

The Treasurer writes that 'These changes, combined with APRA's announced dual-phase licensing regime, will support innovation and encourage greater participation and competition in the financial system by reducing barriers faced by new entrants'.

Timeline: Consultation will close on 4 May 2018.

[Sources: Treasurer Scott Morrison media release 16/04/2018; Treasury media release 16/04/2018; Exposure draft: Financial Sector (Shareholdings) Amendment (Relaxing Ownership Restrictions) Bill 2018; Explanatory statement; [registration required] The Australian 17/04/2018]

Open Banking | Is the banking industry employing delaying tactics on open banking?

The Australian writes that representatives of the fintech industry have questioned the motivation of the banks and more particularly of the Australian Banking Association in calling for a phased implementation of Open Banking (see: Governance News 3 April).

The Australian reports that a number of FinTech representatives have suggested such calls are motivated by a desire to 'protect their most lucrative offerings' and have urged government to 'hold the line' on the implementation timetable.

[Source: [registration required] The AFR 17/04/2017]

Insurance in Superannuation Code of Practice | Potentially in conflict with competition law?

According to The Australian, AMP and Macquarie Super appear to be the only trustees (of the 25 largest superannuation funds) not to have signed up to a new code of ethics, The *Insurance in Superannuation Voluntary Code of Practice* for superannuation trustees (see: Governance News 15/01/2018) which among other things, is aimed at cutting down on excessive life insurance fees.

Reportedly, AMP has expressed concern that the code could come into conflict with competition law and has raised the issue with both the Financial Services Council, which represents the life insurance and wealth management sectors, and the Association of Superannuation Funds of Australia. AMP is quoted as stating that given these concerns: 'AMP is therefore not in a position to confirm any intention to commit to the ISWG code while this significant issue is outstanding'. The article adds that AMP has indicated that it is 'working through the detail' of the code to ensure that it reflect the interests of members and said 'a better outcome is one code for all life insurance customers'.

Reportedly Macquarie, has indicated it has not reached a decision on whether to sign up to the code.

The article adds that the industry working group Chair, Jim Minto reportedly commented that it was the industry's 'best attempt' and was likely to become more robust over time.

[Source: [registration required] The Australian 17/04/2018]

In Brief | The Australian Securities and Investments Commission (ASIC) has confirmed the completion of a compliance review and remediation program, and removal of additional licence conditions, for Total Financial Solutions Australia Limited (TFSA). The remediation program resulted in $2,549,291 being paid in compensation to clients.

[Source: 18-103MR Total Financial Solutions' compliance review results in $2.5m remediation to customers]

Risk Management

Sudden retirement? The CEO of WPP PLC, the 'longest serving FTSE 100 CEO' has reportedly stepped down after 33 years in the role following the completion of an investigation into alleged personal misconduct.

The WSJ writes that CEO of WPP PLC, Martin Sorrell has reportedly stepped down from his role after 33 years, following the conclusion of an investigation into alleged personal misconduct (alleged misuse of company assets) by Mr Sorrell. The WSJ reports that neither Mr Sorrell nor WPP have made any comment about the findings of the investigation and adds that the details will remain confidential (though the Guardian suggests that the findings may be released).

Quoting from an internal WPP memo, the WSJ reports that WPP said 'The investigation had no connection to or impact on our operations or clients. Our work for clients is unaffected and continues uninterrupted'.

Reportedly, WPP added that Mr Sorrell’s departure is being treated as a retirement and the search has commenced for a replacement CEO.

The WSJ quotes Mr Sorrell as stating: 'Obviously I am sad to leave WPP after 33 years. It has been a passion, focus and source of energy for so long…However, I believe it is in the best interests of the business if I step down now.' The article goes on to quote a memo reportedly written by Mr Sorrell to WPP staff as stating: 'As I look ahead, I see that the current disruption we are experiencing is simply putting too much unnecessary pressure on the business…That is why I have decided that in your interest, in the interest of our clients, in the interest of all shareowners, both big and small, and in the interest of all our other stakeholders, it is best for me to step aside'.

Reportedly, Mark Read, chief executive of WPP Digital, and Andrew Scott, WPP's chief operating officer for Europe of WPP have been appointed to act as joint COO, and Roberto Quarta, Chair of the WPP board will reportedly act as executive chair until a new CEO is appointed.

Both the WSJ and The FT comment that, WPP's stock has dropped significantly (over 30%) over the past 12 months, the WSJ adding that its most recent quarter was reportedly the worst for the company since the global financial crisis. The Guardian reports that observers believe that Mr Sorrell's departure 'will have rapid and catastrophic ramifications for WPP and the wider global advertising ecosystem'.

[Sources: [registration required] The WSJ 14/04/2018; [registration required] The FT 16/04/2018; The Guardian 15/04/2018]

Restructuring and Insolvency

Consultation on Ipso Facto Insolvency regulations

Treasury has released the exposure draft of the *Corporations Amendment (Stay on Enforcing Certain Rights) Regulations* 2018 (the regulations) and the *Corporations (Stay on Enforcing Certain Rights) Declaration* 2018 (the declaration) for consultation.

The draft regulations exclude certain contracts from the stay on the enforcement of ipso facto clauses outlined in the *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act* 2017 (Cth) which received Royal Assent on 18 September 2017. The draft declaration similarly excludes certain types of contractual rights.

Treasury writes that the exemptions outlined in both the regulations and the declaration recognise that in 'some circumstances it is necessary or desirable for ipso facto clauses to continue to operate, for example, where there is an established market mechanism already in place or where it would be a commercial nonsense for an ipso facto clause to be stayed'.

In announcing the release of the draft regulations and draft declaration, Minister for Revenue and Financial Services Kelly O'Dwyer said: 'These reforms promote business recovery and restructuring by assisting viable but financially distressed companies to continue to operate and salvage the remaining value of the business, increasing the likelihood of selling the business as a going concern…These exemptions recognise that sometimes staying the operation of the ipso facto clauses is either unnecessary or undesirable; for example, where there is an established market mechanism already in place and the ipso facto stay would significantly disrupt those markets, or where staying them would upset the operation of other domestic or international laws'.

Minister O'Dwyer added that the regulations and declaration will be made prior to the commencement of the primary legislation on 1 July 2018. Comments on the draft regulations and declaration close on 11 May 2018

[Sources: Minister for Revenue and Financial Services Kelly O'Dwyer media release 16/04/2018; Exposure Draft – Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018*; Explanatory Statement* – Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018*]*