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Boards and Directors

Draft legislation to modernise business registers and introduce a legal framework for the implementation of director identification numbers (DINs) has been released for consultation.

The government released draft legislation: *Commonwealth Registers Bill 2018* and *Treasury Laws Amendment (Registries Modernisation and Other Measures) Bill 2018* for consultation on 1 October. The draft Bills propose to implement the government's 2018-19 Federal Budget measures to modernise business registers and introduce Director Identification Numbers (DINs).

Announcing the consultation on the reforms, Assistant Treasurer Stuart Robert said that the modernisation of the business registers would 'help transform the way business interacts with government, making it easier and faster to start and run a business'. He added that the proposed reforms would 'support open data and encourage innovative uses of business data'.

Commenting on DINs, he said the measure would assist regulators and external administrators in addressing the 'perennial problem' of phoenix activity (as well as director involvement in other possible unlawful activity).

Key points

1. **Modernisation of business registers:** The draft legislation proposes to create the *Commonwealth Registers Act 2018* and to amend existing laws to create a new Commonwealth business registry regime. The draft legislation proposes to move certain existing legal registers administered by ASIC onto a single platform to be administered by the Australian Business Registrar (ABR) within the ATO. This includes the registers for companies, business names, ABNs and others. While ASIC's registry functions will be shifted to the ABR, ASIC will continue to administer all of its regulatory functions under the current ASIC laws.

   - **Fees?** Treasury states that no decision has been made on any changes to current fee structures and 'invites discussions with stakeholders about fees, including fees for searching the registers to improve access to data and delivery of quality, sustainable services'.

   - **Timeline?** Treasury writes that a detailed business case, currently under development, will inform the implementation timeline. Treasury adds that the modernised business registry platform is expected to be delivered 'iteratively over time'.

   - **Two stage consultation:** A second round of consultation will be held 'shortly' on the remainder of 'the referrals of functions and consequential changes' necessary to 'facilitate a modern government registry regime'.

- **Legal framework for Director Identification Numbers (DINs):** The draft legislation proposes to introduce a legal framework for the proposed regime for Director Identification Numbers (DINs). The DIN is a unique identifier, will also allow the regulator to map the relationships between directors and entities over time. This is intended to 'assist regulators and external administrators to investigate a director's involvement in what may be repeated unlawful activity including illegal phoenix activity' the explanatory memorandum states. The draft legislation sets out who will be required to obtain a DIN, the obligations associated with a DIN, the consequences of not meeting those obligations and how DINs will be administered. Under the proposed legislation, a person appointed as a director of a body corporate would be required to apply for a DIN within 28 days. Existing directors will have 15 months to apply from the date the new requirement starts.

Timeline: Consultation on the draft legislation closes on 26 October.

[Sources: Assistant Treasurer Stuart Robert media release 01/10/2018; Treasury media release 01/10/2018; Explanatory Memorandum; Bill 1 – Commonwealth Registers Bill 2018; Bill 2 – Treasury Laws Amendment (Registries Modernisation and Other Measures) Bill 2018 (includes Director Identification Numbers); Frequently Asked Questions]

Related News: Governance Institute submission has argued that the planned DIN should be expanded to also cover company secretaries.

In response to the government's Modernising Business Registers Program Consultation Paper, the Governance Institute submission argued that the proposed DIN should be expanded to include company secretaries. Acting Chief Executive Meegan George said: 'Governance Institute has long advocated for, and welcomes, the introduction of Director Identification Numbers. These numbers will be a unique identifier which a person will keep for life and will enable better tracking of directors of failed companies and prevent the use of fictitious identities…Similar to directors, company secretaries are officeholders required by the Corporations Act to provide their personal details to ASIC and we consider that the DIN regime should extend to them.'

DIN removes the need to publish other personal information? In addition, the submission argued that the provision of a DIN removes the need to make address and date and place of birth data publicly available and that the open publication of birth dates, residential addresses and birthplaces serves no useful purpose other than for persons with criminal intent. 'We believe that while it is appropriate that ASIC request and retain the personal details of all officeholders on a database, such data should not be available on the public register. The public register should display the officeholder name, DIN and an address for service to enable legal papers to be served upon them' Ms George said.

[Source: Governance Institute media release 26/09/2018]

Diversity

In Brief | A simple way to increase board diversity? Noting the dearth of women on boards, the AFR questions why so few companies advertise boardroom jobs publicly. 'Instead of relying on the chairman's network of contacts to quietly sound out candidates, or a head hunter's private list, why not simply place an advert'? The idea is neither 'new nor welcome' (due to concerns over being swamped with unsuitable candidates) but 'it is a good first step' the AFR suggests.

[Source: [registration required] The AFR 02/10/2018]

Remuneration

Will Australia follow the UK and the US and require firms to report the ratio of CEO pay to median worker pay? Labor has announced that if elected, it will introduce the requirement. The AFR reports that Domino's Pizza CEO Don Meij has called on the coalition to adopt the policy.

Shadow Assistant Treasurer Andrew Leigh has announced that if elected, Labor will require all listed Australian companies with more than 250 employees to disclose the ratio of CEO pay to the median employee from the 2021 financial year. This will allow, he said, time for the Australian Securities and Investments Commission (ASIC) to issue appropriate guidance and for firms to comply with the new requirements. Under the plan, alongside their pay ratio, firms would also be 'encouraged' to provide a public explanation of the remuneration strategy. Mr Leigh notes that the policy follows the introduction of similar requirements in the US and the UK.

Mr Leigh writes that the policy is intended to address 'public concern that CEO salaries are growing at an unfair rate and leaving workers behind'. The announcement references the Australian Council of Superannuation Investors (ACSI) report into CEO remuneration (see: Governance News 23/07/2018) in support of this view. The survey found that average total pay of ASX100 CEOs rose at four times the rate of average wage growth in 2017, with the median ASX 100 CEO earning more than $4m.

The AFR reports that Domino's CEO Don Mr Meij (who is identified in the ACSI report as Australia's best paid CEO) has called on the government to adopt Labor's policy on the basis that it 'would promote transparency and help lift the pay of workers, and would not be onerous for firms which already kept significant data on employee pay'. Reportedly Mr Meij has also called for the government to go a step further than Labor and extend the requirement to multinationals operating in Australia. 'One of the things that is unfortunate is we sometimes just target our own... but what about the foreign nationals? Shouldn't they have to behave inside the same laws for the market?' Mr Meij said.

[Sources: Shadow Assistant Treasurer Andrew Leigh media release 02/10/2018; [registration required] The AFR 02/10/2018]

Disclosure and Reporting

United States | SEC has announced a settlement with Tesla Inc and CEO/Chair Elon Musk over Tweets: Tesla Inc has agreed to corporate governance and other reforms, including the removal of Mr Musk as Chair. In addition, Tesla and Mr Musk have agreed to pay $US40m in financial penalties.

The Securities and Exchange Commission (SEC) has announced the details of settlements with Tesla Inc CEO and Chair Elon Musk, and with Tesla Inc, in relation to Tesla CEO Elon Musk's August tweet regarding the possibility of taking the company private (see: Governance News 27/08/2018; 13/08/2018). SEC writes that the settlements, which are subject to court approval, will result in 'comprehensive corporate governance and other reforms at Tesla—including Musk's removal as Chairman of the Tesla board — and the payment by Musk and Tesla of financial penalties'.

SEC's complaint against Mr Musk: SEC's complaint alleges that when Mr Musk tweeted on 7 August 2018 that he could take Tesla private at $420 per share and that funding had been secured, he 'knew that the potential transaction was uncertain and subject to numerous contingencies'. More particularly, SEC writes that Mr Musk had 'not discussed specific deal terms, including price, with any potential financing partners, and his statements about the possible transaction lacked an adequate basis in fact'. SEC alleges that Mr Musk's 'misleading' tweets caused Tesla's stock price to jump by over 6% on 7 August, and led to significant market disruption.

SEC's complaint against Tesla Inc: SEC's complaint against Tesla alleges that 'Tesla had no disclosure controls or procedures in place to determine whether Musk's tweets contained information required to be disclosed in Tesla's SEC filings. Nor did it have sufficient processes in place to that Musk's tweets were accurate or complete'.

Details of the settlement

SEC writes that Mr Musk and Tesla have agreed to settle the charges against them without admitting or denying the SEC's allegations. The settlements require (among other things) implementation of the following.

- **$40m in financial penalties:** Mr Musk and Tesla Inc will each pay a separate $20 million penalty. The $40 million in penalties will be distributed 'to harmed investors under a court-approved process'.
- **Governance reforms including the following**:
  - Mr Musk will step down as Tesla's Chair and be replaced by an independent Chair. Mr Musk will be ineligible to be re-elected as Chair for a period of three years.
  - Tesla will appoint a two new independent directors to its board.
  - Tesla will establish a new committee of independent directors and put in place additional controls and procedures to oversee Mr Musk's communications.

Stephanie Avakian, Co-Director of the SEC's Enforcement Division said: 'The total package of remedies and relief announced today are specifically designed to address the misconduct at issue by strengthening Tesla's corporate governance and oversight in order to protect investors'.

SEC Chair Jay Clayton issued a statement in which he said that he 'fully supported the filing of the action. I also fully support the settlements agreed today and believe that the prompt resolution of this matter on the agreed terms, including the addition of two independent directors to the Tesla board and the other governance enhancements at Tesla, is in the best interests of our markets and our investors, including the shareholders of Tesla. This matter reaffirms an important principle embodied in our disclosure-based federal securities laws. Specifically, when companies and corporate insiders make statements, they must act responsibly, including endeavouring to ensure the statements are not false or misleading and do not omit information a reasonable investor would consider important in making an investment decision'.

[Sources: SEC media release 29/09/2018; SEC complaint against Tesla; SEC complaint against Elon Musk; SEC public statement by Chair Jay Clayton 29/09/2018; Harvard Law School Forum on Corporate Governance and Financial Regulation 01/10/2018; Business Insider 01/10/2018]

Media reports

The announcement of the settlements has received wide media coverage.

- **Lighter punishments for 'indispensable' executives going forward?** The FT has interpreted the settlement as an endorsement by SEC Chair Jay Clayton (and by extension the SEC) of the view that Mr Musk is indispensable to the success of Tesla, and that consequently, unduly harsh punishment would only harm investors. The article cites Mr Clayton's statement, and more particularly his comments that 'the interests of ordinary shareholders — who had no involvement in the misconduct — are intertwined with the interests of offending officials and the company...[and] the skills and support of certain individuals may be important to the future success of a company' in support of this view. The article goes on to suggest that Mr Clayton's comments 'also open the door for other high-profile executives and their lawyers to argue that harsh penalties on them would simply punish shareholders'.
- **Private actions now the 'real worry' for Tesla?** Reuters quotes the director of the Weinberg Center for Corporate Governance at the University of Delaware Charles M Elson as suggesting that private actions (by short sellers and other investors alleging losses and securities laws violations) are now the 'real worry' for Tesla and that the size of the fine 'bolsters investors' claims' over stock market losses. The report adds that the Department of Justice investigation into the issue is also still pending.
- **Unrepentant?** The Australian reports that Mr Musk is 'apparently taunting' the SEC on his Twitter account following the settlement. On 4 October Mr Musk praised the 'Shortseller Enrichment Commission' for 'doing incredible work'.

[Sources: [registration required] The FT 02/10/2018; Reuters 01/10/2018; [registration required] The AFR 02/10/2018; [registration required] The Australian 05/10/2018]

Regulators

Australian Securities and Investments Commission (ASIC)

Top Story | ASIC's review of compliance with breach reporting obligations has identified 'unacceptable delays by financial institutions in reporting, addressing and remediating significant breaches'.

Australian Securities and Investments Commission (ASIC) *Report 594: Review of selected financial services groups' compliance with breach reporting obligation* sets out the findings of ASIC's review of Australian financial services (AFS) licensees' compliance with their breach reporting obligation under s912D of the *Corporations Act 2001 (Cth)*. The review examined the breach reporting processes of 12 financial services groups which provide services such as banking, superannuation, investment management, insurance and financial advice. The sample included the big four banks (ANZ, CBA, NAB and Westpac) and AMP. The report found that there are 'serious, unacceptable delays in the time taken to identify, report and correct significant breaches of the law among Australia's most important financial institutions'.

Some key findings

- **Delays in identifying 'significant breaches':** Overall, the report found that 'financial institutions are taking too long to identify significant breaches'. ASIC states that on average 1,517 days (over 4 years) pass until the incident is identified. For major banks, the average time was 1,726 days (over 4.5 years) to identify a breach.

- **Delay in lodging a breach report:** Once a financial institution has investigated and determined that a breach has occurred and that it is significant, firms are required to report the breach to ASIC within 10 business days. According to the report, one in seven significant breaches (110 of 715) were reported later than that 10-business day requirement. The report found that the major banks take an average of 150 days to report a breach (from starting an investigation) which is 'double that of the other groups' reviewed (which averaged 73 days).

- **Delays in remediating customers:** According to the report, it took an average of 226 days from the end of a financial institution's investigation into the breach and first payment to impacted consumers. ASIC notes that this is in addition to the average 1,517 days before the breach is discovered and the time taken to start and complete and investigation. Overall, the report found that it takes financial institutions 1,899 days (over 5 years) to begin remediating customers.

- **Remediation yet to be provided:** According to the report, financial losses to consumers due to 'significant breaches' within the scope of ASIC's review totalled approximately $500m with many customers yet to be compensated.

ASIC Chair has called on industry to improve

ASIC Chair James Shipton attributed many of the delays 'the financial institutions' inadequate systems, procedures and governance processes, as well as a lack of a consumer orientated culture of escalation'. More particularly, he highlighted the time taken to identify and investigate potential breaches and the time taken to report it within the 10 day time-frame as areas for improvement.

He went on to call on industry to invest in 'systems and processes' as well as for boards and senior executives to commit to address these significant failings.'

Breach reporting confirmed as an area of immediate focus: Mr Shipton also reiterated that breach reporting will be an area of focus in ASIC's 'Close and Continuous Monitoring approach to supervising major institutions' (see: Governance News 10/09/2018). He added that 'ASIC is also actively considering enforcement action for failures to report breaches on time'.

Need for law reform? Mr Shipton said that the review 'underscores the need for law reform of the breach reporting requirements, that the Government has committed to in principle, following the ASIC Enforcement Review'. He the identified three 'barriers' to enforcement action, which in his view, would be addressed by the proposed reforms.

1. The test as to whether a breach is significant and therefore is legally required to be reported is subjective. That is, the licensee makes that decision based on its own assessment, not based on objective grounds.

2. The 10-business day period for reporting only begins once an institution has determined that there is a breach and that it is significant. Institutions can delay making those decisions without breaching the law.

3. Failures to report can only be prosecuted on a criminal basis with the associated high standard of proof. At the same time the existing penalty is relatively modest.

[Note: Among the reforms proposed by the Taskforce were changes in relation to the self-reporting of contraventions by financial services and credit licensees. These included clarification of the 'significance test' to 'ensure that the significance of breaches is determined objectively'. The report also recommended that the time for reporting should be extended from 10 to 30 days, but that licensees should be required to make a report if they commence 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'. See: Governance News 23/04/2018.]

[Sources: ASIC media release 25/09/2018; Report 594: Review of selected financial services groups' compliance with the breach reporting obligation]

The Australian Banking Association (ABA) released a statement in response to the report, which said it is a 'further wake up call to the banks to lift their game in quickly fixing issues in their business'. ABA CEO said 'this investigation shows that banks efforts to identify issues, report them to ASIC and compensate customers is not good enough. Customers expect these problems to be identified and fixed as soon as possible. Clearly this report shows there's a lot of work to be done'. Ms Bligh went on to note that the industry had cooperated fully with the ASIC Enforcement Review and 'supported changes including increasing penalties and introducing a civil penalty in addition to the criminal offence for failing to report within the required timeframe'. She added that industry is also supportive of ASIC's continuous monitoring program.

[Source: Australian Banking Association media release 25/09/2018]

Financial Advice reforms | ASIC has released guidance on code of ethics compliance schemes for financial advisers

The Australian Securities and Investments Commission (ASIC) has released guidance: *Regulatory Guide 269: Approval and oversight of compliance schemes for financial advisers* (RG 269), on its proposed approach to approving and overseeing compliance schemes for financial advisers. RG 269 also sets out ASIC's expectations for the way in which schemes should operate including in relation to:

- the governance and administration of compliance schemes (eg governance, resources, out-sourcing);
- monitoring and enforcement processes (eg proactive monitoring activities; reactive monitoring activities; appeals and dispute resolution; enforceability of the monitoring body's decisions); and
- ongoing operation of compliance schemes (eg data collection, analysis and reporting, reporting of serious contraventions and systemic issues; independent review).

RG 269 includes 'if not, why not' checklists which 'will require the monitoring body [eg financial advice professional association or professional services firm] to either confirm that it will comply with the expectations in our guidance or, if not, explain why this is the case and the alternative approach the monitoring body will take'.

ASIC deputy chair Peter Kell said ASIC is committed to ensuring robust, transparent, fair and consistent compliance schemes that effectively monitor and enforce compliance with the code of ethics. 'Effective compliance schemes are a key component of the reforms that will require higher standards of ethical behaviour and professionalism among financial advisers' Mr Kell said. 'Our guidance requires high standards for compliance schemes, reflecting the significant responsibility that monitoring bodies operating compliance schemes will have. This includes the responsibility to effectively monitor and sanction adviser members if required.'

Context: From 1 January 2020, financial advisers will be required to comply with a code of ethics and be covered by an ASIC-approved compliance scheme under which their compliance with the code of ethics will be monitored and enforced.

The Financial Adviser Standards and Ethics Authority (FASEA) are developing a code of ethics and it has not yet been finalised. A draft version of the code of ethics was released by FASEA on 19 March 2018. Consultation on the draft code closed on 1 June 2018. ASIC states that 'If there are significant changes from the draft code, we may need to revise our guidance when the final code is released'.

[Sources: ASIC media release 28/09/2018; Regulatory Guide 269: Approval and oversight of compliance schemes for financial advisers 28/09/2018]

ASIC commits to being a 'strategic and forceful regulator' with a focus on small business

ASIC commitment to be a 'strategic as well as forceful regulator'

In its Corporate Plan for 2018-19 to 2021-22 Australian Securities and Investments Commission (ASIC) Chair James Shipton writes that the Financial Services Royal Commission has 'highlighted the harms that unlawful and unethical conduct can inflict on consumers and investors' and eroded trust in the sector. He went on to say that ASIC is a 'core part of the financial system' and that the regulator has an 'important role in driving the behaviours that will build and restore trust'. He said that ASIC 'will do this by being a strategic as well as forceful regulator' and by:

- 'proactively identifying harms to consumers (including vulnerable consumers such as Indigenous Australians), investors and markets
- prioritising and addressing the most significant harms
- accelerating enforcement outcomes
- implementing new supervisory approaches
- promoting adoption of regulatory technology (regtech) by industry'.

Small Business Focus

Small business was also identified in the plan as an area of focus. More particularly ASIC has said that in the financial year ahead ASIC will focus 'on poor culture and professionalism in financial services and credit, particularly in the provision of consumer credit and financial advice, the fair treatment of small business, and the use of consumer data by firms (including data governance)'. In addition, ASIC said it will continue to review lenders' compliance with small business protections in unfair contract terms legislation (including compliance by lenders outside the big four banks) and offer broader support to small business.

ASIC said it will also focus on compliance by small business, in particular, illegal phoenix behaviour, non-compliance with financial reporting obligations and director misconduct.

Progress update on Small Business Strategy

ASIC launched its Small Business Strategy 2017-2020 in August 2017 and provided a progress update. Highlights include:

- More than 366,000 new business names and 244,000 new companies were registered, and over 122 million searches of ASIC's registers were conducted.
- ASIC responded to over 692,000 enquiries through its various communication channels.
- ASIC has successfully prosecuted 382 entities/individuals for 734 offences relating to failure to keep books and records, which ASIC states is often an indicator of illegal phoenix activity.

[Sources: ASIC media release 02/10/2018; ASIC's Corporate Plan 2018-22, Focus 2018-19; Small business infographic]

In Brief | ASIC has announced fee relief and financial counselling for the drought-affected: ASIC announced that it is offering assistance in the form of relief from various company-related fees that may be payable and providing information about financial counselling services for farmers and related businesses suffering financial hardship as a result of the current drought.

[Source: ASIC media release 27/09/2018]

In Brief | Managed discretionary account providers must now be licensed: MDA providers who do not have the required AFS licence authorisations must cease providing MDAs from 1 October 2018 until they have obtained those authorisations.

[Source: ASIC media release 01/10/2018]

In Brief | New fintech/regtech cooperation agreements: ASIC has signed a fintech cooperation agreement with the US Commodity Futures Trading Commission and separately, ASIC has entered a cooperation agreement on fintech and regtech issues with its Luxembourg counterpart (CSSF).

[Sources: ASIC media release 05/10/2018; 05/10/2018]

Financial Services

Royal Commission into Misconduct in the banking, superannuation and financial services industry (Financial Services Royal Commission)

Top Story | Financial Services Royal Commission Interim Report released

Introduction

The Financial Services Royal Commission's Interim Report was tabled by the Government on 28 September 2018. It identifies a range of policy issues to emerge over the course of the first four rounds of hearings, that is in relation to: consumer lending (round 1); financial advice (round 2); loans to small and medium enterprises (SMEs) (round 3) and issues emerging in relation to experiences with financial services entities in regional and remote communities (round 4). Issues in relation to superannuation (round 5) and insurance (round 6) will be covered in the final report due by 1 February 2019. The deadline for submissions in response to the issues raised in the Interim Report is 26 October 2018.

Scope of the Interim Report

The Interim Report does not contain draft recommendations or refer entities to legal authorities. Rather, it identifies issues in relation to banking, loan intermediaries and the provision of financial advice, arising from the first four rounds of hearings, and 'poses a series of questions, directing attention to considerations that may bear upon what conclusions I [Commissioner Hayne] should reach, and what recommendations I should make...in response to the more particular issues identified in the Terms of Reference'. These issues are:

- the adequacy of the existing laws and policies to the provision of banking and related financial services;
- the adequacy of the internal systems of financial services entities;
- the adequacy of existing forms of industry self-regulation (including industry codes of conduct);
- the effectiveness and ability of regulators to identify and address misconduct;
- the effectiveness of mechanisms for redress for consumers;
- whether changes are needed (in relation to each of the first three points) to minimise the likelihood of misconduct in the future.

Context and timeline

- **Timeline for submissions on the Interim Report:** The Commission will accept submissions in response to issues raised in the Interim Report until 26 October.
- **Round 7 hearings:** The seventh and final round of public hearings will focus on policy questions arising from the first six rounds of hearings (ie including superannuation and insurance, which are not addressed in the Interim Report). Hearings will take place between 19 November and 23 November.
- **Final report:** The final report is due to be submitted to the Governor General by 1 February 2019. The report will include the topics of the fifth (superannuation), sixth (insurance) and seventh round of hearings (policy questions arising in relation to the first four rounds of hearings).

Road map: The structure of the Interim Report

The Interim Report consists of three volumes.

- **Issues/common themes to emerge**: Volume 1 outlines the issues to emerge in relation to each round of hearings (rounds 1-4), as well as providing background on the establishment of the Commission, the approach taken to the selection of case studies and work completed outside the hearings.
  - Chapter 8 (Volume 1) identifies issues to emerge over the first four rounds of hearings in relation to existing regulation and the response of the regulators to the conduct identified in the report.
  - Chapter 9 (Volume 1) considers the causes of the misconduct identified over the course of the first four rounds of hearings.
  - Chapter 10 (Volume 1) sets out the policy questions to emerge in relation to each topic and identifies 'common threads and some more general questions'.
- **Case studies:** Volume 2 of the report outlines the evidence in relation to each case study and identifies a number of instances in which entities may have breached the law, engaged in conduct that may have fallen below community standards and expectations, and/or potentially breached the Code of Banking Practice (Banking Code).
- **Appendices:** Appendices to the report including (among other things) a list of submissions made to the Commission, a list of background papers and an outline of the public submissions received are set out in Volume 3.

Policy issues arising in relation to Round 6 hearings

- Separately, the Commission has also released a document outlining the policy issues to emerge from round 6 hearings on the topic of Insurance.

[Note: The policy issues to emerge in relation to the Round 6 hearings are outlined in a separate post in the 8 October issue of Governance News.]

Issues to emerge

Commissioner Hayne categorises the issues to emerge in relation to the first four rounds of hearings into the following categories:

- 'intermediaries – the confusion of roles and responsibilities
- customer needs – you "need" what we have to sell
- credit risk or unsuitable lending? Lending is not unsuitable if the consumer is unlikely to default
- processing errors – failure to deliver promised features of products sold'.

'Why did it happen?' and 'What can be done to avoid it happening again?'

The report takes these questions as its starting point. More particularly the report asks these questions in relation to banks, loan intermediaries and financial advice, 'with a view to provoking informed debate about both questions'.

Why the conduct occurred

A culture of 'greed'

In response to the question of why the conduct occurred, Commissioner Hayne identifies ‘pursuit of profit’ or ‘greed’ as a ‘unifying cause’ of the issues identified. ‘Much if not all of the conduct identified in the first round of hearings can be traced to entities preferring pursuit of profit to pursuit of any other purpose' he writes. He adds, 'Too often, the answer [to why the conduct occurred] seems to be greed – the pursuit of short term profit at the expense of basic standards of honesty'.

Commenting specifically in relation to banks, Commissioner Hayne writes that 'the banks have gone to the edge of what is permitted, and too often beyond that limit, in pursuit of profit. And they have gone beyond the limit because they can; and because they profit from the misconduct that is described in this report. Risk to reputation was ignored'.

Other causes identified

Other causes identified and discussed in the Interim Report include: conflict of interest and duty, remuneration structures, culture and governance, and the regulatory response.

- **Remuneration structures as a driver of conduct:** The Commissioner writes that 'conduct identified and criticised in this report was conduct that provided a financial benefit to the individuals and entities concerned. (If there were exceptions, they were immaterial.) The governance and risk management practices of the entities did not prevent the conduct. The culture and conduct of the banks was driven by, and was reflected in their remuneration practices and policies'.
- **Cultural/governance deficiencies:** Commissioner Hayne writes that the 'same or similar deficiencies of governance and risk culture' identified in APRA's report into CBA culture, appear (based on issues identified over the course of the first four round of hearings) to be present in other financial services entities. 'The conduct suggests that there has been insufficient attention given within those entities to regulatory and compliance risk. It suggests want of attention by those entities to reputational risk. Some of the conduct suggests want of proper governance in the entity'.
- **Business Structures (vertical integration):** Commissioner Hayne comments in relation to this issue: 'The inescapable fact seems to be that interest too often trumps duty. Too often conflicts between interest and duty are "managed" in a way that coincides with the interests of the party who owes some conflicting duty or has some conflicting interest'.
- **Role of the Regulators:** The report questions the effectiveness of the approach taken by both the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) in deterring and preventing the misconduct identified, and in enforcing compliance with existing laws. 'When misconduct was revealed, it either went unpunished or the consequences did not meet the seriousness of what had been done. The conduct regulator, ASIC, rarely went to court to seek public denunciation of and punishment for misconduct. The prudential regulator, APRA, never went to court' Commissioner Hayne writes. Though he emphasises that individual entities are ultimately responsible for their own conduct, he also identifies the approach taken by the regulators as a contributing factor in the misconduct: 'Too often entities had been treated in ways that would allow them to think that they, not ASIC, not the parliament, not the courts would decide when and how the law would be obeyed or the consequences of the breach remedied' he writes. 'Much more often than not, when misconduct was revealed, little happened beyond apology from the entity, a drawn out remediation program and protracted negotiation with ASIC of a media release, an infringement notice, or an enforceable undertaking that acknowledged no more than that ASIC had reasonable "concerns" about the entity's conduct'.

What should the response be?

Regulation and the regulators

Chapter 8 the Interim Report identifies issues to emerge over the first four rounds of hearings in relation to regulators and regulation with a focus on why the breaches were 'so many and so widespread' and whether changing the law would 'make any difference'.

In posing these questions, Commissioner Hayne emphasises that ultimately 'each financial services entity is responsible for its own conduct' and that 'the criticisms that are made of the ways that regulators have responded to this conduct must not be understood as diminishing in any way the culpability of the entities that engaged in the relevant conduct.' However, he is also critical of both the effectiveness of the current approach taken by the regulators to enforcing compliance with the law, and the complexity of the existing law.

A need for ASIC to adopt a new approach to enforcement?

Commenting on ASIC’s enforcement approach, the Commissioner writes: 'When deciding what to do in response to misconduct, ASIC’s starting point appears to have been: How can this be resolved by agreement? This cannot be the starting point for a conduct regulator. When contravening conduct comes to its attention, the regulator must always ask whether it can make a case that there has been a breach and, if it can, then ask why it would not be in the public interest to bring proceedings to penalise the breach. Laws are to be obeyed. Penalties are prescribed for failure to obey the law because society expects and requires obedience to the law'.

Commenting on APRA's approach to enforcement, Commissioner Hayne writes that 'APRA is obliged to look at issues of governance and risk culture through the lens of financial system stability. Understood in that light, APRA’s lack of action in response to the widespread occurrence of the conduct described in this report may, perhaps, be more readily understood'.

Policy questions identified

Particular policy questions identified in relation to these issues include the following**.**

- ‘How should APRA and ASIC respond to conduct and compliance risk?’
- ‘Should the regulatory architecture change?’
- ‘Are some tasks better detached from ASIC?’
- ‘Are some tasks better detached from APRA?’
- ‘What authority should take up any detached task?’
- ‘Should either or both of ASIC and APRA be subject to external review?’

Particular policy questions identified in relation to ASIC include the following.

- ‘Is ASIC’s remit too large? If it were to be reduced, who would take over those parts of the remit that are detached? Why would detachment be better?’
- ‘Is the regulatory regime too complex? Should there be radical simplification of the regulatory regime?’
- ‘Should ASIC’s enforcement priorities change? In particular, if there is a reasonable prospect of proving contravention, should ASIC institute proceedings unless it determines that it is in the public interest not to do so?’
- ‘If the recommendations of the Enforcement Review are implemented, will ASIC have enough and appropriate regulatory tools?’

Particular questions in relation to APRA include the following.

- ‘Are APRA’s regulatory practices satisfactory? If not, how should they be changed?’
- ‘Does the conduct identified and criticised in this report call for reconsideration of APRA’s prudential standards on governance?’
- ‘Having examined the governance, culture and accountability within the CBA group, what steps (if any) can APRA take in relation to those issues in other financial services entities?’

Further regulation?

- **Not necessarily a question of further regulation?** Commissioner Hayne questions whether additional regulation is likely to be effective in addressing the issues identified. He writes: 'The law already requires entities to "do all things necessary to ensure" that the services they are licensed to provide are provided "efficiently, honestly and fairly". Much more often than not, the conduct now condemned was contrary to law. Passing some new law to say, again, "Do not do that", would add an extra layer of legal complexity to an already complex regulatory regime. What would that gain?' On this basis, he writes that 'I begin from the premise that no new layer of law or regulation should be added unless there is clearly identified advantage to be gained by doing that. And I begin from the further premise that very simple ideas must inform the conduct of financial services entities. Hence, the first question to be asked and answered is: Is the law governing financial services entities and their conduct too complicated? Does it impede effective conduct risk management? Does it impede effective regulatory enforcement?'.

- **'Different enforcement' of existing law and/or simplification of existing law?** The report questions whether a 'different' approach to enforcement should be adopted: 'Should the existing law be administered or enforced differently? Is different enforcement what is needed to have entities apply basic standards of fairness and honesty: by obeying the law; not misleading or deceiving; acting fairly; providing services that are fit for purpose; delivering services with reasonable care and skill; and, when acting for another, acting in the best interests of that other? The basic ideas are very simple. Should the law be simplified to reflect those ideas better?'
- **A case for 'simplification'?** Commissioner Hayne argues that there is 'a need to simply the existing law' to enable greater focus on 'the very simple ideas that must inform the conduct of financial services entities: Obey the law. Do not mislead or deceive. Be fair. Provide services that are fit for purpose. Deliver services with reasonable care and skill. When acting for another, act in the best interests of that other'. He goes on to say that 'The more complicated the law, the easier it is for compliance to be seen as asking 'Can I do this?''
- **Policy questions identified** in relation to these issues include the following.
  - 'Are changes in law necessary? Should the financial services law be simplified?'
  - 'Should carve outs and exceptions be reduced or eliminated? In particular, should grandfathered commissions; point of sale exceptions to the NCCP Act; funeral insurance exceptions be reduced or eliminated?'

Remuneration

Should the way in which bank staff are paid be re-thought?

- **Is incentive remuneration necessary?** The report questions the assumption that incentive remuneration (which the Commissioner notes is paid to most bank staff) is necessary. 'The unstated premise for so much of the debate about remuneration of both bank staff and intermediaries, that staff and intermediaries will not do their job properly and to the best of their ability without incentive payments, must be challenged. And in the case of intermediaries, arguments based in predictions of industry damage or collapse should be examined with special care' he writes.
- **Why do staff require incentives?** 'Why do staff (whether customer facing or not) need incentives to do their job unless the incentive is directed towards maximising revenue and profit? How can staff (especially customer facing staff) be encouraged to do the right thing (to ask 'Should I') except by the line manager observing, encouraging counselling and supporting the staff in that task? What is the point of allowing an incentive payment for doing the assigned task in a way that meets but does not exceed what is expected of that staff member?' the Commissioner writes.
- **Should incentives be paid to executives?** Commissioner Hayne also questions whether bonuses should be paid to more senior staff/executives. 'If customer facing staff should not be paid incentives, why should their managers, or those who manage the managers? Why will altering the remuneration of front line staff effect a change in culture if more senior employees are rewarded for sales or revenue and profit?' he writes.

Particular policy questions in relation to these issues include the following.

- 'What more should be done to implement the recommendations of the Sedgwick Review?'
- 'Should any bank employee dealing with a customer be rewarded (whether by commission or as part of an incentive remuneration scheme) for selling the client a product of the employer? That is, should any 'customer facing employee' be paid variable remuneration? '

- 'If the answer is either 'no' or 'some should not' what follows about incentive remuneration for managers or more senior executives? If more junior employees should not be remunerated in this way, why should their managers and senior executives?'
- 'Should other changes be made to the remuneration practices of banks? What would they be, and how could change be required?'

The BEAR (Banking Executive Accountability Regime)

- 'Is the Banking Executive Accountability Regime ('the BEAR') relevant to the intersections between remuneration and culture more generally than in its application to particular senior executives?'
- 'Should the BEAR be altered?'
- 'Should the BEAR be extended in application?'

Conflicts of interest arising from business structures (Vertical integration)

Particular policy questions identified in relation to this issue include:

- 'Do the events that have happened suggest that manufacturers of financial products should not be permitted to provide, whether by employee or authorised representative, personal financial advice in relation to products of a kind it manufactures?'
- 'Do the events that have happened raise any issue about business structures?'
- 'Do the events that have happened invite consideration of whether structural changes should now be made?'
- More particularly, do they provoke examination of how and to what extent conflicts of interest and duty arising from the structure of the business can be managed?

Other policy questions in relation to specific issues

Particular policy questions identified by the Commissioner in relation to each of the first four rounds of hearings, and the themes to emerge, are identified in Chapter 10, Volume 1 of the Interim Report. Some of the questions identified in relation intermediaries and in relation to responsible lending are below.

Roles and responsibilities of intermediaries

The Interim Report identifies a number of policy questions concerning the role of intermediaries (mortgage brokers, mortgage aggregators, introducers, financial advisers, authorised representatives of financial services licensees and representatives at point of sale of credit licensees). Policy questions identified in the report include the following (among others).

- 'For whom do the different kinds of intermediary (mortgage brokers, mortgage aggregators, introducers, financial advisers, authorised representatives of Licensees, point of sale sellers of loans) act? For whom should each kind of intermediary act?'
- 'If intermediaries act for the consumer of a financial service: What duty do they now owe the consumer? What duty should they owe?'
- 'Who is responsible for each kind of intermediary's defaults? Who should be responsible?'
- 'How should intermediaries be remunerated?'
- 'Are external dispute resolution mechanisms satisfactory?'
- 'Should there be a mechanism for compensation of last resort?'

Responsible lending

- 'Should the test to be applied by the lender remain "not unsuitable"? How should the lender assess suitability? Should there be some different rule for some home loans?'
- 'Should the NCCP Act [*National Consumer Credit Protection Act* 2009 (Cth) (the NCCP Act)] apply to any business lending? In particular, should any of its provisions apply to: SMEs? agricultural businesses? some guarantors of some business loans?'
- 'To what business lending should the Banking Code of Practice apply? Is the definition of "small business" satisfactory?'
- 'Should lenders adopt different practices or procedures with respect to agricultural lending?'
- 'Are there classes of persons from whom lenders should not take guarantees; or should not take guarantees unless the person is given particular information or meets certain conditions?'
- 'How should lenders manage exit from a loan at the end of the loan's term; if the borrower is in default?'

Response to the release of the Interim Report

- **Treasurer Josh Frydenberg** released a statement welcoming the release of the report and commenting that it, and the hearings to date, 'make clear that some financial institutions have fallen far short of treating Australians honestly and fairly'. He went on to outline the reforms already in on foot to 'reform the financial sector' adding that 'there is clearly more work to be done'. He went on to say that the government looks forward to receiving the Commission's final report by 1 February 2018 and 'acting on its recommendations'.
- **Australian Banking Association (ABA):** In a short statement, the ABA said: 'Today's release of the Interim Report of the Royal Commission into Financial Services, Insurance and Superannuation, marks a day of shame for Australia's banks. There are no excuses for the behaviour that has been exposed by the Royal Commission. Banks accept responsibility for their failures and right now they are working day and night to make things right for their customers'. The statement adds that 'We will fix these problems and make them right without delay, to earn back the trust of the Australian public'.
- **Governance Institute:** Acting CEO Meegan George said that the 'The findings of the Interim Report raise issues of major concern — particularly greed — the pursuit of short term profit at the expense of ethical behaviour…The CEO and board of directors are key to influencing and improving good corporate culture. They need to put the voice of the customer first, not just the customer's wallet.' Ms George went on to call for a 'wide-ranging conversation on the clarity of the role of the board versus the executive and how organisations are held to account for unethical behaviour'. Commenting on the issue of the possible change in enforcement approach/simplification of legal requirements suggested in the report, Ms George said: 'The report also raises crucial questions on whether the law should be administered or enforced differently…Governance Institute considers the Corporations Act as important economic infrastructure and we support reforms to modernise and simplify it — particularly those provisions impacting on customers and retail investors'.
- **Australian Institute of Company Directors (AICD):** In a statement, the AICD said that the 'revelations and testimony Revelations in testimony at the Commission about misconduct have been confronting and disturbing.' The statement goes on to say that the AICD 'is committed to leading the governance community' in responding to the report 'I am confident the 43,000 strong membership of the AICD is committed to meeting the highest standards of governance. As part of that commitment, the messages of the Interim Report are ones we must hear. The misconduct revealed by the Royal

Commission has contributed to the historically low levels of trust in our institutions. The task of restoring that trust is one that the AICD community will play a vital part in'.

[Note: The AICD has released a Summary of the implications of the Interim Report and it is available on the AICD website here]

- **NAB:** In a statement, CEO Andrew Thorburn said 'For us at NAB, where we have made mistakes or done the wrong thing, we will own them and fix them. It is difficult to face the statement of 'profits before people', but this is exactly what we need to confront. Banking was built on putting people first and earning the trust of customers. We must return to these principles once again, rather than continuing to be short term managers.'

- **Westpac:** In a statement, Westpac CEO Brian Hartzer said: 'The Royal Commission has identified many examples of misconduct across the industry. I apologise to any customers who have been impacted by mistakes that we have made'. The statement outlines the steps Westpac has already implemented and notes that 'we still have more work to do'.

- **CBA:** In response to the Interim Report Commonwealth Bank of Australia CEO Matt Comyn said: 'The Royal Commission's Interim Report released today is confronting and rightly critical of our industry and our bank. We have seen too many examples of unacceptable behaviour and unacceptable customer outcomes. The Commission has highlighted the need for significant changes, particularly to systems, processes and culture. I am committed to making sure that we learn from the failures detailed in this report to fix what went wrong and put things right for our customers. We have already made a number of changes and will make more to meet the community's expectations and earn trust. The vast majority of our people do the right thing by their customers every day. They have also been let down'. Mr Comyn added that CBA will provide a submission to the Commission on the issues raised.

- **AMP:** In response to the report, AMP acting CEO Mike Wilkins issued a statement acknowledging the release of the Interim Report and noting that 'under the direction of new leadership, AMP has reset our business to accelerate positive changes in culture, governance, regulatory reporting and performance' and outlines some steps being taken. The statement adds 'We know we have more to do and we are committed to doing it'.

[Sources: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Interim Report; Governance Institute of Australia media release 28/09/2018; AICD media release 28/09/2018; Treasurer Josh Frydenberg media release 28/09/2018; AMP media release 28/09/2018; NAB media release 28/09/2018; Westpac 28/09/2018]

Top Story | Financial Services Royal Commission Round 6 Insurance — Policy questions arising

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission) sixth round of public hearings focussed on insurance (life insurance, general insurance and the regulatory regime). A high level overview the policy questions arising from round 6 hearings is below.

[Note: See: Governance News 17/09/2018 and 21/09/2018 for coverage of some of the case studies considered over the course of the Insurance hearings.]

Some key questions identified

- **Are consumers adequately protected?** 'Is the current regulatory regime adequate to minimise consumer detriment? If the current regulatory regime is not adequate to achieve that purpose, what should be changed?' (eg is there any reason not to extend unfair contracts protections to insurance contracts?)

- **What role do regulation and the regulators play in enforcing culture?** 'When a financial services entity identifies that it has a culture that does not adequately value compliance, what should it do? What role, if any, can financial services laws and regulators play in shaping the culture of financial services entities? What role should they play?' (eg should ASIC have jurisdiction in respect of the handling and settlement of insurance claims?

- **Role of incentives:** Is banning conflicted remuneration 'sufficient' to address the use of inappropriate sales tactics by sales representatives (and the consequent risk to consumers)?
- **Resourcing compliance systems:** 'Should there be greater consequences for financial services entities that fail to design, maintain and resource their compliance systems in a way that ensures they are effective in: preventing breaches of financial services laws and other regulatory obligations; and ensuring that any breaches that do occur are remedied in a timely fashion?'
- **Should certain products be sold at all? Should outbound sales be banned?** Among the policy questions identified were the questions of whether the sale of accidental death and accidental injury products and the sale of add-on insurance by motor dealers should be prohibited. The Commission also questioned whether the use of sale of insurance via direct phone calls (outbound sales) should be banned.

Further detail

Policy questions identified include the following.

- **Adequacy (or not) of existing the regulatory regime?** Is the current regulatory regime adequate to minimise consumer detriment? If the current regulatory regime is not adequate to achieve that purpose, what should be changed?' are the general policy questions identified in relation to the Insurance hearings. The theme of the adequacy (or not) of the existing regulatory regime, and what further changes may or may not be necessary to address the issues identified over the course of the Round 6 hearings runs through many of the more specific questions outlined below.
- **Extension of unfair contacts terms protects to insurance contracts:** Is there any reason why unfair contract terms protections should not be applied to insurance contracts in the manner proposed in "Extending Unfair Contract Terms Protections to Insurance Contracts", published by the Australian Government in June 2018?

[Note: On 27 June, the government released a proposal paper: *Extending Unfair Contract Terms Protections to Insurance Contracts* outlining a model to extend unfair contract term (UCT) provisions to insurance contracts regulated under the Insurance Contracts Act 1984 (Cth) (IC Act) for consultation. The Model proposed amending s15 of the IC Act to allow UCT provisions in the ASIC Act to apply to insurance contracts regulated by the IC Act and tailoring the application of the UCT provisions o 'take account of the specific features of insurance where necessary'. Consultation closed on 27 July. See: Governance News 2/07/2018]

- **Role of regulation and regulators in enforcing culture**: When a financial services entity identifies that it has a culture that does not adequately value compliance, what should it do? What role, if any, can financial services laws and regulators play in shaping the culture of financial services entities? What role should they play?

[Note: The Interim Report which raises policy questions in relation to the first four rounds of public hearings was released on 28 September. Chapter 8 (Volume 1) of that report focuses on the role of regulators and regulation in shaping culture/preventing misconduct and questions (among other things) whether a different approach to enforcement, should be considered. The Interim Report is available on the Commission's website here. For a high level summary of some of the issues considered in the report see: Governance News 08/10/2018.]

- **Stronger powers for ASIC?** Are there any recommendations in the ASIC Enforcement Review Taskforce Report published by the Australian Government in December 2017, that should be supplemented or modified?

[Note: The ASIC Enforcement Review 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 2018. 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 agreed, or agreed in principle, to all Taskforce recommendations. See: Governance News 23/04/2018. Consultation on draft legislation to implement recommendations in relation to stronger civil and criminal penalties for corporate misconduct is currently on foot, and will conclude on 23 October. The draft legislation: *Treasury Laws Amendment (ASIC Enforcement) Bill 2018* is covered in a separate post in the 08/10/2018 issue of Governance News.]

- **Resourcing compliance systems:** Should there be greater consequences for financial services entities that fail to design, maintain and resource their compliance systems in a way that ensures they are effective in: preventing breaches of financial services laws and other regulatory obligations; and ensuring that any breaches that do occur are remedied in a timely fashion?
- **Product Design**
  - 'Are there particular products – like accidental death and accidental injury products – which should not be sold?'
  - Should the requirements of the Life Insurance Code of Practice in relation to updating medical definitions be extended to products other than on-sale products?'
- **Disclosure**
  - **Adequacy of the existing statutory requirements:** 'Is the current disclosure regime for financial products set out in Chapter 7 of the Corporations Act 2001 (Cth) and Division 4 of Part IV of the Insurance Contracts Act 1984 (Cth) adequately serving the interests of consumers? If not, why not, and how should it be changed?'

    The Commission requested that submissions address the following: the purpose(s) that the product disclosure regime should serve; whether the current regime meets that purpose or those purposes; and how financial services entities could disclose information about financial products in a way that better serves the interests of consumers'. The Commission notes that despite the reference to the Insurance Contracts Act, the question is 'not limited in scope to contracts of insurance.
  - **Standardised definitions:** 'Is the standard cover regime in Division 1 of Part V of the Insurance *Contracts Act 1984 (Cth)* achieving its purpose? If not, why not, and how should it be changed? Is there scope for insurers to make greater use of standardised definitions of key terms in insurance contracts?'
- **Sales practices**
  - **Payment of incentives:** 'Should monetary and non-monetary benefits paid in relation to general insurance products remain exempt from the ban on conflicted remuneration and if so, why? In addition, should monetary benefits given in relation to life risk insurance products remain exempt from the ban on conflicted remuneration? Why shouldn't the cap on such benefits continue to reduce to zero?'
  - **Is banning conflicted remuneration sufficient?** 'Is banning conflicted remuneration sufficient to ensure that sales representatives do not use inappropriate sales tactics when selling financial products? Are other changes, such as further restrictions on remuneration or incentive structures, necessary?'
  - **Ban on outbound sales?** Should the direct sale of insurance via outbound telephone calls be banned? If not, is the current regulatory regime governing the direct sale of insurance via outbound telephone calls adequate to avoid consumer detriment? If the current regulatory regime is inadequate, what should be changed?
  - **Should 'general advice' be renamed (in line with Productivity Commission Report recommendation 10.2)?** The Productivity Commission report (PC Report) into Competition in the Financial System included the recommendation that 'general advice' be renamed (and more particularly that the term 'advice' should 'only be used in association with 'personal advice') to improve consumer understanding of the nature of the information being provided (recommendation 10.2). The PC recommended that the change should be implemented by

mid-2020. The Commission asked whether this is 'sufficient to address the problems that can arise where financial products are sold under a general advice model' and 'If not, what additional changes are required? Are there some financial products that should only be sold with personal advice?'

  - **Use of approved product lists?** 'Should all financial services entities that maintain an approved product list be required to comply with the obligations contained in FSC Standard No 24: Life Insurance Approved Product List Policy?'

[Note: The FSC Standard No 24: Life Insurance Approved Product List Policy states that the purpose of the policy is 'to encourage high standards in life insurance Approved Product List (APLs) construction practices that encourage competitive access and choice for advisers and their clients in life insurance products. The Standard also outlines processes for 'off' APL recommendations to ensure that adviser can access other products to enable them to meet best interest obligations.]

- **Add on insurance**
  - **Ban on motor dealers selling add-on insurance?** 'Should the sale of add-on insurance by motor dealers be prohibited? Alternatively, should add-on insurance only be sold via a deferred sales model? If so, what should be the features of that model? Would a deferred sales model also be appropriate for any other forms of insurance? If so, which forms?
  - **Should commissions be banned in this context? '**If the ban on conflicted remuneration is not extended to apply to general insurance products, should the payment of commissions for the sale of add-on insurance by motor dealers be limited or prohibited?'
- **Claims Handling: '**Should the obligations in section 912A of the Corporations Act 2001 (Cth) apply to all aspects of the provision of insurance, including the handling and settlement of insurance claims? Should ASIC have jurisdiction in respect of the handling and settlement of insurance claims?'
- **Life insurance**
  - **Pre-existing conditions:** 'Should life insurers be prevented from denying claims based on the existence of a pre-existing condition that is unrelated to the condition that is the basis for the claim? Should life insurers who seek out medical information for claims handling purposes be required to limit that information to information that is relevant to the claimed condition?'
  - **Use of surveillance: '**Should life insurers be prevented from engaging in surveillance of an insured who has a diagnosed mental health condition or who is making a claim based on a mental health condition? If not, are the current regulatory requirements sufficient to ensure that surveillance is only used appropriately and in circumstances where the surveillance will not cause harm to the insured? If the current regulatory requirements are not sufficient, what should be changed?'
- **General insurance:** 'Should the General Insurance Code of Practice be amended to provide that, when making a decision to cash settle a claim, insurers must: act fairly; and ensure that the policyholder is indemnified against the loss insured (as, for example, by being able to complete all necessary repairs)?'
- **Insurance in Superannuation**
  - **Universal minimum coverage requirements?** 'Should universal minimum coverage requirements; and/or key definitions; and/or key exclusions, be prescribed for group life policies offered to MySuper members?'
  - **Definitions:** 'Should group life insurance policies offered to MySuper members be permitted to use a definition of 'total and permanent incapacity' that derogates from the definition of 'permanent incapacity' contained in regulation 1.03C of the *Superannuation Industry (Supervision) Regulations 1994 (Cth)*?'

- **Role of RSE Licensees**:

  - Should RSE Licensees be obliged to ensure that their members are defaulted to statistically appropriate rates for insurance required to be offered through the fund under section *68AA(1) of the Superannuation Industry (Supervision) Act 1993 (Cth)*?

  - 'Should RSE Licensees be prohibited from engaging an associated entity as the fund's group life insurer? Alternatively, should RSE Licensees who engage an associated entity as the fund's group life insurer be subject to additional requirements to demonstrate that the engagement of the group life insurer is in the best interests of beneficiaries and otherwise satisfies legal and regulatory requirements, including the requirements set out in paragraphs 22 to 24 of Prudential Standard SPS 250, Insurance in Superannuation?'

- **Voluntary Code of Practice: '**Are the terms set out in the Insurance in Superannuation Voluntary Code of Practice sufficient to protect the interests of fund members? If not, what additional protections are necessary?'

Written Submissions: The Commission has released written submissions in response to Round 6 hearings on Insurance. These can be accessed via the Commission's website here.

Round 7 hearings: The seventh and final round of public hearings will focus on policy questions arising from the first six rounds of hearings (ie including superannuation and insurance). Hearings will take place between 19 November and 23 November.

[Source: Financial Services Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Round 6 hearings: Policy questions arising from the Module 6 case studies]

In Brief | Extension of time for the Commission looks unlikely? The Guardian reports that Labor is hosting a series of roundtables around the country in places that the Financial Services Royal Commission has not visited, to provide a platform for rural and regional Australians to tell their stories as part of a campaign to extend the Commission. Reportedly the government has said that it is open to extending the Commission, should the Commissioner request it. To date, no request has been made.

[Source: The Guardian 02/10/2018]

Other Developments

Open Banking update | Consultation on stage 2 of exposure draft legislation to implement the Consumer Data Right (CDR)

On 15 August, the government released an exposure draft of legislation to implement a consumer data right — *Treasury Laws Amendment (Consumer Data Right) Bill 2018* — for consultation (see: Governance News 20/08/2018).

Following this, the government released the second stage of exposure draft legislation: *Treasury Laws Amendment (Consumer Data Right) Bill 2018: Provisions for further consultation* for consultation on 24 September. Treasury writes that the revised definitions and Privacy Safeguards sections of the exposure draft, reflect feedback from public consultation on the first tranche of draft legislation.

Key changes (since the earlier exposure draft include the following)

- **Designating a sector — scope of the instrument and the factors the Minister must consider:** The Explanatory Memorandum states that the Minister's powers to designate a sector of the economy as subject to the consumer data right (CDR) have been more clearly set out. In addition to the previously set out factors the Minister must consider prior to designating a sector, the Minister must consider the likely effect on any intellectual property in the information to be covered by the instrument.

- **Limiting the application of the CDR:** The explanatory materials state that during the first consultation a number of stakeholders were concerned about the scope of the definition of CDR data and the requirement to share derived or value added data. In response, a limitation on the ACCC's rules making powers has been included in the Bill (though the definition of CDR data remains unchanged). More particularly, the Bill has been amended so that:
  - Where the information relates to a consumer, the ACCC can only make consumer data rules which require access and transfer of information that is in the designation instrument.
  - For information not relating to a consumer the ACCC rules making powers requiring access and transfer are limited to information about the eligibility criteria, terms and conditions, or price of a product, other kind of good, or a service.
- **Definition of CDR consumer:** During the first consultation a number of stakeholders noted that the definition of 'CDR consumer' could apply more broadly than intended. In response, the definition has been revised so that a CDR consumer is 'an identifiable or reasonably identifiable person, including a small, medium or large business enterprise, to which the CDR data relates because of the supply of a good or service either to the person or an associate of the person' the explanatory material states.
- **Data reciprocity:** During consultation stakeholders requested further information about how reciprocity would operate within the CDR regime. Reciprocity will operate to allow the ACCC to write rules requiring data recipients to provide customers access to data, or the ability to request disclosure of data to accredited parties. Reciprocity will apply to:
  - **Equivalent data** which is data included within a class in the designation instrument which has not been transferred within the CDR system and which is held by an accredited data recipient; and/or
  - **Received data:** Data that recipients have received through the CDR.

  Though the concept of reciprocity will be given effect through rules made by the ACCC, the definition of data holder has been amended to clarify the treatment of data in the hands of certain accredited entities.
- **Interaction of Privacy Safeguards with the Privacy Act:** The first consultation identified the need to further clarify the interaction of the Privacy Safeguards implemented under the CDR with the existing privacy protections in the Privacy Act. It was not clear whether an entity would need to meet obligations under both the Privacy Safeguards and Privacy Act for the same data. The Bill has been amended to reduce this complexity and better clarify the obligations which fall on a data holder and accredited data recipient.

Other proposals

Treasury is also seeking views on the following proposals:

- Introduction of further legislative consultation requirements for sectoral designation and rule-making.
- Introduction of limitations on the rule-making power in regards to charges for licenses to access and use data.
- Treasury is also seeking views on the designation instrument for the banking sector (Open Banking).

Timeline: The consultation period closes on 12 October 2018. The proposed timeline for implementation of Open Banking is unchanged. The proposed commencement date for Open Banking (for data on credit and debit card, deposit and transaction accounts of the Big Four banks) is 1 July 2019.

[Sources: Treasury media release 24/09/2018; CDR proposals for further consultation; Treasury Laws Amendment (Consumer Data Right) Bill 2018 – Provisions for further consultation; Explanatory Materials (Provisions for further consultation); Explanatory Materials (Provisions for further consultation); Explanatory Materials (Provisions for further consultation); Treasury Consumer Data Right timeline]

Consumer Credit | Australia's largest consumer credit reporting agency Equifax has been ordered to pay $3.5 million in penalties and to remediate consumers after admitting that its representatives used unfair sales tactics and made misleading representations about its paid credit reports.

The Federal Court has imposed total penalties of $3.5m on Equifax Australia Information Services and Solutions Pty Ltd (Equifax) and $100,000 toward the ACCC's costs, for misleading and deceptive conduct and unconscionable conduct relating to credit report services following Equifax's admissions that its representatives made false or misleading representations to consumers in phone calls.

According to the ACCC, Equifax admitted that:

- It breached the Australian Consumer Law (ACL) in 2016 and 2017, when its representatives made false or misleading representations to consumers during phone calls. Equifax told consumers that its paid credit reports were more comprehensive than free reports it had to provide under the law, when in fact they contained the same information.
- Equifax also admitted it told consumers they would be charged a single 'one-off' or 'one-time' payment, but failed to disclose that payments for its paid credit report packages would automatically renew unless consumers opted out.
- Equifax also told consumers that the credit score provided in its paid credit reports was the same credit score used by credit providers when that was not always the case.
- In respect of three vulnerable consumers, Equifax also admitted that it acted unconscionably by using unfair sales tactics and making misleading representations during telephone calls.

The court also ordered, by consent, that Equifax establish a consumer redress scheme to allow affected consumers to seek refunds for a 180 day period. The penalties ordered were based on admissions made by Equifax and joint submissions on penalty made by Equifax and the ACCC.

'This result sends a strong message to businesses that making misrepresentations and acting unconscionably against consumers will not be tolerated' ACCC Commissioner Sarah Court said.

[Sources: ACCC media release 02/10/2018; Equifax corrective notice]

In Brief | In line with the recommendations of the inquiry into Reforms for Cooperatives, Mutual and Member owned Firms, the government is consulting on draft legislation which proposes to: introduce a definition of a mutual entity and remove the 'uncertainty' for transferring financial institutions and friendly societies in respect of the demutualisation provisions in Part 5 of Schedule 4 of the Corporations Act 2001 (Cth).

[Sources: Exposure Draft: Treasury Laws Amendment (Mutual Entities) Bill 2018; Draft Explanatory Material; Treasury Media release 04/10/2018]

Risk Management

Cybersecurity

APRA has issued an updated information paper on managing risks associated with outsourcing cloud computing services and cautioned that entities can expect that the 'better practices' outlined will be incorporated into future prudential standards/guidance.

The Australian Prudential Regulation Authority (APRA) has released an updated information paper regarding: *Outsourcing involving shared computing services*.

Though APRA acknowledges that advancements in cloud computing service offerings in the three years since the information paper was originally issued have improved the ability of APRA-regulated entities to manage the risks involved, is also 'emphasises the need for entities to be mindful of the differing levels of responsibility for operating and managing these arrangements'. The updated paper outlines 'better practices' in relation to managing these risks.

- **Low inherent risk:** For arrangements with low inherent risk not involving off-shoring, APRA would not expect an APRA-regulated entity to consult with APRA prior to entering into the arrangement.
- **Heightened risk:** For arrangements with heightened risk, APRA would expect to be consulted after the APRA-regulated entity's internal governance process is completed.
- **Extreme inherent risk:** For arrangements involving extreme inherent risk, APRA encourages earlier engagement as these arrangements will be subjected to a higher level of scrutiny.

Incorporation into future prudential standards: APRA cautions entities that it intends 'to incorporate the better practices described in the paper into prudential standards and practice guides in the future. Any such changes will be subject to APRA's normal processes of consultation'.

[Sources: APRA media release 24/09/2018; APRA information paper: Outsourcing involving shared computing services 24/09/2018] In Brief | The Monetary Authority of Singapore's Cyber Security Advisory Panel has suggested a number of ways in which financial institutions can strengthen their cyber resilience including: using reputable cloud solution providers with strong cybersecurity capabilities; providing greater transparency to their customers on how they implement security measures to protect their systems and information; performing risk assessment of any third parties using their APIs and monitoring activities related to API services for suspicious events; and building bug bounty programs and 'red-teaming' into their security testing frameworks to assist in identifying vulnerabilities.

[Source: MAS media release 05/10/2018]

In Brief | Test of the General Data Protection Regulation (and the requirement to report breaches within 72 hours): Facebook could reportedly be fined as much as $US1.63m by Ireland's Data Protection Commission in connection with a data breach in which hackers reportedly compromised the accounts of 50 million EU based users. Facebook's share price reportedly fell following reports of the breach. Under GDPR, companies face fines if they fail to take sufficient steps to safeguard user data and are also required to report breaches within 72 hours.

[Sources: [registration required] The Australian 02/10/2018; Itnews 03/10/2018]

Corporate Misconduct and Liability

Top Story | Tougher penalties for 'white collar crime'? The government is consulting on draft legislation which proposes to impose increased penalties for corporate and financial sector misconduct.

Introduction

Draft legislation: *Treasury Laws Amendment (ASIC Enforcement) Bill 2018* intended to strengthen penalties for corporate and financial sector misconduct was released by the government for public consultation on 26 September. The proposed changes implement certain of the ASIC Enforcement Taskforce Review recommendations (see: Governance News 23/04/2018).

Commenting on the proposed reforms, Treasurer Josh Frydenberg emphasised that they significantly increase existing penalties. 'The proposed changes would double maximum imprisonment penalties and significantly increase financial penalties for some of the most serious "white-collar" criminal offences bringing Australia's penalties in closer alignment with leading international jurisdictions'. He also highlighted that 'The financial penalty for individuals for civil contraventions would also be increased more than five fold, from $200,000 to $1.05 million, or three times the benefit gained (whichever is greatest) from the contravention. Contraveners may also be stripped of ill-gotten gains from their illegal activities'.

Timeline: Consultation closes on 23 October 2018.

Key Points

- The draft Bill makes amendments to ASIC-administered legislation (Schedule 3 to the Corporations Act, and to the ASIC Act and the Credit Act), to increase the maximum imprisonment term for certain criminal offences, including:
  - increasing the maximum imprisonment penalties for certain criminal offences;

- introducing a formula to calculate financial penalties for criminal offences;
- removing imprisonment as a penalty and increasing the financial penalties for all strict and absolute liability offences.

Other proposed changes include the following.

- Introduces ordinary criminal offences that sit alongside strict and absolute liability offences.
- Modernises and expands the civil penalty regime by increasing financial penalties for contraventions and making a wider range of offences subject to civil penalties.
- Harmonises and expands the infringement notice regime.
- Introduces a new test that applies to all dishonesty offences under the Corporations Act.
- Introduces relinquishment as a remedy available in civil penalty proceedings.
- Clarifies that the courts are to give priority to compensating victims over ordering the payment of financial penalties; and
- Clarifies that contraventions of section 184 of the Corporations Act can occur even when the relevant corporation gains an advantage from the contravention.

Treasurer Josh Frydenberg commented: 'The Government is committed to ensuring ASIC is properly armed 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 sectors'.

Response to the proposed reforms

- **The Australian Institute of Company Directors (AICD) issued a statement welcoming the** consultation on the proposed changes and noting that it has 'long called for stronger criminal and civil penalties for corporate misconduct'. AICD Managing Director & CEO Angus Armour said: 'Tough penalties serve a deterrent effect, and importantly will help restore and retain community trust…The vast majority of company directors in Australia do the right thing. Those that don’t should feel the full weight of the law'. The statement adds that the AICD will provide a submission to the Treasury consultation.

[Sources: Treasurer Josh Frydenberg media release 26/09/2018; Treasury media release 26/09/2018; Exposure draft: Treasury Laws Amendment (ASIC Enforcement) Bill 2018; Draft explanatory materials; AICD media release 25/09/2018]