Governance News

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Mark Standen
Partner
Email Mark

T +61 2 9921 4902 | M +61 412 104 902

Siobhan Doherty
Partner
Email Siobhan

T +61 2 9921 4339 | M +61 413 187 544

Kate Hilder
Consultant
Email Kate

T +61 2 9921 8785 |

For queries or to subscribe/unsubscribe to Governance News updates, please contact: kate.hilder@minterellison.com

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What's driving the gender pay gap in Australia? KPMG has determined that gender discrimination remains the largest contributing factor

Report Overview | She's Price(d)less: The economics of the gender pay gap August 2019

Key Takeouts

- The gender pay gap stands at 14% with men earning $241.50 per week more than women.
- The most significant drivers of the gender pay gap in Australia continue to be: 1) gender discrimination; 2) issues relating to family and care (including work interruptions); and 3) industrial and occupational segregation (ie overrepresentation of women in lower paid positions and industries)
- The report argues that addressing barriers to equality is 'critical' to both the development of Australian society and the nation's economic growth'

Building on previous 2009 and 2016 reports into the factors driving the gender pay gap in Australia, KPMG (with the Diversity Council of Australia and the Workplace, Gender Equality Agency) has released an updated report.

Some Key Findings

- **Gender Pay Gap:** Australian Bureau of Statistics data shows that the gender pay gap exists nationally across industries and occupations in Australia. The gap between men and women in full time average weekly earnings is currently 14%
- **Gender Discrimination:** The report found that gender discrimination remains the most significant contributing factor to the gender pay gap, accounting for 39% of the gap (up from 29% in 2014). This is in line, the report comments with a 'considerable body of evidence' about the impact of discrimination on wage gaps in Australia and elsewhere.
- **Factors relating to family and care collectively accounted for 39% of the gender pay gap**
  - Career interruptions accounted for 25% of the gender wage gap (up 2% on 2014)
  - Part time employment accounted for 7% of the gender wage up (up from 6% on 2014). This finding is consistent with the relative lack of change in the gender composition of the part time workforce over this time period.
  - Unpaid care/work (proxied by hours per week on house work) accounted for 7% (up from 6% in 2014).
- **Industrial and occupational segregation** continue to be a significant factor together accounting for 17% of the 2017 gender pay gap (an overall decrease on 2014 when occupational and industrial segregation together accounted for 31% of the gap)

Opportunity?

The report argues that closing the primary drivers of the gender pay gap is equivalent to $445m per week or $23bn per year. As such, doing so has potential to deliver important economic as well as social benefits for women, families and the Australian community.

[Sources: KPMG media release 22/08/2019; KPMG Report: She's Price(d)less: The economics of the gender pay gap; Report Summary; The ABC 22/08/2019; The Guardian 22/08/2019; [registration required] The AFR 22/08/2019]

United Kingdom | Too early to say whether it's a blip or a trend? The latest High Pay Centre/CIPD report into trends in executive pay has found that overall, FTSE 100 CEO pay has fallen to its lowest level since 2010

Report Overview | High Pay Centre, Executive Pay in the FTSE 100

Key Takeouts

- Overall, the report found that FTSE 100 CEO pay is at its lowest level since 2010
- The gap between the highest paid executives and the rest of the workforce has decreased, though the median FTSE 100 CEO reward package is still 117 times bigger than that of a UK full-time worker on a median salary of £29,574
- The fall may indicate that boards are starting to be more mindful of stakeholder expectations/governance reforms are having an impact, but emphasis that 'it's too early to tell' given CEO tends to fluctuate year to year
- From a gender diversity perspective, the report found that a FTSE 100 CEO is more likely to be called Steve or Stephen than to be female. Female CEOs were paid 32% less on average than their male counterparts

The latest annual CIPD/High Pay Centre report into trends in executive remuneration focused on understanding the extent to which publicly listed companies are responding to new Corporate Governance standards, particularly with respect to how they reward their most senior executives.

Overall the report found that there was an overall fall in CEO pay, which may indicate that some boards are starting to be more mindful of wider stakeholder expectations and that shareholder scrutiny is intensifying, but emphasises that 'it's too early to tell'. 'CEO pay has gone up and down every year since 2010, so we won't know if this is the start of a longer-term downward trend until next year' the report states.

Some Key Points

Gender Diversity

- **A FTSE 100 CEO is more likely to be called Steve or Stephen than to be female.** The number of CEOs in the FTSE100 decreased from seven in the last report to six.
- **Female CEOs were paid 32% less on average than their male counterparts.** In FYE 2018, male CEOs in the FTSE 100 earned a mean of £4.80 million compared with £3.25 million for women.
- **Board representation?** Across the FTSE 100, 31% of the 1,053 board positions are held by women and 41% of FTSE 100 remuneration committee positions are held by women. Only 8% of executive board members are women, a drop from 10% last year. By the end of FYE 2018 there were just 22 female executive directors in the FTSE 100 compared with 237 male executive directors

FTSE 100 CEO pay has fallen overall

- **Overall, companies were found to have 'shown more constraint' in rewarding their CEOs in 2018 as compared with previous years:** As at June 2018, the mean CEO pay package was £4.70m which is a 16% drop on last year. The median CEO pay package was £3.46m which is a 13% drop on last year.
- **Less and 50% (43) of FTSE100 companies awarded their CEO a higher pay package than in 2017**
- **The CEO to worker pay ratio has narrowed:** The mean ratio of CEO to employee pay remained static at 114:1 as compared with 2017. The ratio of median pay to employee pay narrowed from 77:1 to 72:1. Despite this, the report comments that the gap is still wide raising 'possible concerns among staff that the way that CEO performance is rewarded isn't fair compared with how their own efforts are recognised'. Stagnant wages and income inequality remain, the report observes, live political issues the report

observes. The report comments that a more meaningful comparison of pay ratios across all FTSE 100 companies will be possible from 2020 when all listed companies with 250 or more employees will have published their UK employee pay ratios.

- **43 CEOs in the FTSE 100 saw their pay increase between 2017 and 2018.**

- **Complex LTIPs (long-term incentive plans) continue to form the biggest component of executive pay, and were awarded to 84% of CEOs.** Pensions also make up a significant amount of executive reward. As a percentage of base salary, CEOs get a pension contribution (or payment in lieu of) worth 25%. By contrast, employees get a contribution worth 8% of their wages.

- **64% of workers agree that CEO pay is too high in the UK.** Only 4% disagree that this is the case.

FTSE 250 CEO pay?

- Median pay for 250 CEOs has remained steady over the past three years, from £1.58 million in FYE 2016, up 2% to £1.61 million in 2017 and down 2% to £1.58 million in 2018.

- The mean single figure pay of FTSE 250 CEOs has risen steadily over the past three years, from £1.88 million in FYE 2016 to £2.05 million in FYE 2017 and £2.12 million this year, an annual increase of 8% and then 4%.

The 'jury is still out'?

The report cautions the overall reduction in FTSE 100 CEO pay is not necessarily indicative of a trend. Further, though it is 'possible the increased transparency and scrutiny on these reward packages has started to have a moderating effect', CEO packages remain at elevated levels compared with the wider workforce.

As such, the report concludes that 'celebrating' the decrease in CEO 'what could be a temporary dip is… dangerous' because CEO pay, though useful as a 'symbolic reflection of pay gaps in the UK', is only one indicator of inequality across the broader economy.

'There is still more to be done to align pay practices with the interests of wider society and give the public confidence that our biggest businesses are working for the good of the economy as a whole rather than the enrichment of a few people at the top' the High Pay Centre writes.

Recommendations

The report makes four recommendations to improve transparency and accountability around executive pay. These are as follows.

1) **The requirement to disclose a single pay figure should be extended beyond the CEO** to 'key management personnel' and pay for the top 1% of earners (including those in large private firms), to further improve transparency and ensure this area of reporting practice improves.

2) **Remuneration committees should be replaced with formal 'people and culture' committees** or their remit should be broadened to consider organisational culture, fairness and wider workforce reward policies.

3) **The emphasis on non-financial measures of performance should be increased.** In people management terms this can include talent management, inclusion and employee well-being.

4) **CEO reward packages should be simplified to ensure they are linked to fewer and more meaningful measures of performance**.

About the report: The report is based on analysis of the annual reports for the financial year ending in 2018 of the top 100 FTSE companies as at June 2019 as well as on the key single figure data of the next 250 FTSE companies as at 11 June 2019.

[Sources: High Pay Centre media release 20/08/2019; High Pay Centre media release 20/08/2019; Report: Executive Pay in the FTSE 100; Professional Adviser 21/08/2019]

The beginning of a shift in approach? Lion Co has reportedly moved to ban questions on past salary in job interviews as a means of tackling the gender pay gap

The AFR reports that Lion Co (which owns brands Boags, James Squire and Hahn) has banned questions to job candidates about their salary history as part of broader changes to recruitment processes aimed at encouraging more female applicants, and more particularly to address the gender pay gap.

Lion CEO Stuart Irvine said that basing salaries on past pay risks perpetuating existing pay gaps. 'If there's a female applicant and a male applicant and in the interview, they're both successful and we say we'll pay you 10 per cent more than you're currently on — you're just perpetuating the gap into the organisation' Mr Irvine is quoted as saying.

The AFR comments that though 17 US states have recently banned the practice, Lion is the first time that the issue has received attention in Australia.

Reportedly, though there are no studies on how widespread the practice is in Australia, a US survey from 2018 found 84% of employers used salary history to evaluate salary expectations. The AFR quotes University of Sydney Associate Professor in organisational studies, Sunghoon Kim, as saying that salary history will become more significant for Australia as the US bans start to affect multinationals. 'If more than 10 states have this law, that means virtually all companies that have nation-wide operations in the US are under the influence of the ban…If a majority of major corporations are doing that, that means the multinational policies are affected and there are naturally some impacts across nations' Mr Kim reportedly said.

[Source: [registration required] The AFR 26/08/2019]

New pay gap? The WSJ has found that there is on average a 16% difference between what S&P500 firms report paying their CEOs vs the value of the pay package the CEOs actually receive

The WSJ compared what S&P 500 companies reported paying their CEOs over three years (as disclosed in company annual proxy statements) with a measure of what that pay was actually worth at the end of the period, ('realisable pay'), using data from ISS Analytics, the data intelligence arm of proxy adviser Institutional Shareholder Services.

According to the WSJ's analysis:

- on average, the value of the pay at the end of the period was 16% higher than originally disclosed
- pay rose at three out of five companies
- at a third of companies, pay rose by more than 25%

What's behind it? According to The WSJ, a key reason for pay rising is an increasingly common variety of stock and option awards called performance equity which, reportedly made up at least part of the long term pay plans at 83% of S&P 500 companies last year (up from 50% in 2008).

At the time annual pay figures are disclosed, the WSJ comments, most companies have not yet determined how many shares their CEOs will receive under performance equity awards. In consequence, the figures reported may omit 'significant amounts of pay'.

[Source: [registration required] The WSJ 25/08/2019]

In Brief | Could there be an upside to CEO Incentives? A recent post on Harvard Law School Forum presenting the results of a five year study has found that when a higher proportion of CEOs in a nation receive incentives, that nation's GDP increases significantly in the following years. The researchers conclude that 'it appears ubiquitous CEO incentives may result in future positive societal benefits at the macroeconomic national level'

[Source: Harvard Law School Forum on Corporate Governance and Financial Regulation 26/08/2019]

United States | SEC has published guidance regarding the proxy voting responsibilities of investment advisers and interpretation and guidance regarding the applicability of proxy rules

The US Securities and Exchange Commission (SEC) recently released: guidance regarding the proxy voting responsibilities of investment advisers and interpretation and guidance regarding the applicability of the proxy rules.

Some Key Points

SEC Chair Jay Clayton said 'the releases reiterate the Commission's views on the importance of investment advisers' voting responsibly on behalf of their clients and the applicability of our proxy rules to proxy voting advice. Advisers who vote proxies must do so in a manner consistent with their fiduciary obligations and, to the extent they rely on voting advice from proxy advisory firms they must take reasonable steps to ensure the use of that advice is consistent with their fiduciary duties. In addition, proxy advisory firms, to the extent they engage in solicitations, must comply with applicable law.'

Guidance regarding the proxy voting responsibilities of investment advisers

The guidance discusses, among other things:

- How an investment adviser and its client, in establishing their relationship, may agree upon the scope of the investment adviser's authority and responsibilities to vote proxies on behalf of that client
- What steps an investment adviser, who has assumed voting authority on behalf of clients, could take to demonstrate it is making voting determinations in a client's best interest and in accordance with the investment adviser's proxy voting policies and procedures
- Considerations that an investment adviser should take into account if it retains a proxy advisory firm to assist it in discharging its proxy voting duties
- Steps for an investment adviser to consider if it becomes aware of potential factual errors, potential incompleteness, or potential methodological weaknesses in the proxy advisory firm's analysis that may materially affect one or more of the investment adviser's voting determinations
- How an investment adviser could evaluate the services of a proxy advisory firm that it retains, including evaluating any material changes in services or operations by the proxy advisory firm
- Whether an investment adviser who has assumed voting authority on behalf of a client is required to exercise every opportunity to vote a proxy for that client

Applicability of the Federal Proxy Rules to Proxy Voting Advice

SEC writes that 'Under the Commission interpretation, proxy voting advice provided by proxy advisory firms generally constitutes a solicitation subject to the federal proxy rules'. SEC adds that, 'The Commission's interpretation does not affect the ability of proxy advisory firms to continue to rely on the exemptions from the federal proxy rules' filing requirements'.

Additional costs for proxy firms? The WSJ comments that the change (clarifying that proxy advisers are subject to anti-fraud rules concerning materially false or misleading statements) apply to proxy advisers) could 'saddle ISS and Glass Lewis with new legal costs and affect shareholder votes at company annual meetings'. The WSJ adds that additional regulations aimed at the proxy advisers are on the SEC's agenda for the months ahead.

Next steps? SEC writes that the guidance and interpretation will be effective upon publication in the Federal Register

Response?

In a statement acknowledging the release of SEC's guidance, Glass Lewis said it looks 'forward to reviewing the clarifications that the SEC put forth and continuing to engage with them in a constructive manner on these important issues'. The statement adds that Glass Lewis has processes/procedures in place already to enable public companies to understand its policies and methodologies and to engage with Glass Lewis.

It is in the best interest of our investor clients to be able to continue to operate our business and offer services in a manner that doesn't compromise the independence, quality and timeliness of the research that Glass Lewis provides.

Institutional Shareholder Services (ISS) response: The WSJ quotes ISS President and CEO Gary Retelny as saying that ISS will carefully review the guidance to 'understand the potential impacts for our clients as well as to consider further actions that could improve the ability of our clients to meet their fiduciary obligations in a cost effective manner'. Mr Retely reportedly also raised concerns that 'aspects of the guidance may significantly undermine our ability to deliver independent, timely and accurate research, data, insights and perspectives to aid in the discharge of our clients' fiduciary duties'.

[Source: SEC media release 21/08/2019; Harvard Law School Forum on Corporate Governance and Financial Regulation 21/08/2019; [registration required] The WSJ 21/08/2019; Glass Lewis media release 22/08/2019]

Corporate Social Responsibility and Sustainability

Top Story | Entire societies and economies are built upon ethics and trust. MinterEllison's latest podcast, featuring Rupert Younger (Oxford University Centre for Corporate Reputation) and Geraldine Johns-Putra takes a deep dive into this theme

MinterEllison has released a podcast —*Transforming business with MinterEllison: ideas and challenges that are shaping our future* — exploring how leaders can restore trust in their organisations, how they can rewrite the rules to regain trust and who should be responsible for doing that/

The podcast can be accessed via MinterEllison's website here: https://www.minterellison.com/articles/podcast-a-social-licence-the-future-of-business

CII 'respectfully disagrees' with the position taken by Business Roundtable? CII has expressed concern that the recent Business Roundtable Statement redefining the purpose of a corporation undermines management accountability to investors

Responding to the recent Business Roundtable Statement on the purpose of a corporation (see: Governance News 21/08/2019), The Council of Institutional Investors (CII) issued a statement expressing 'concern' that it 'undercuts notions of managerial accountability to shareholders'.

CII writes 'we respectfully disagree with the statement' on the basis that the achievement of long term shareholder value requires not only that companies 'respect stakeholders, but also to have clear accountability to company owners'.

'Accountability to everyone means accountability to no one' CII writes.

CII goes on to say that it supports putting capital to its best use for long-term performance, which includes addressing stakeholder contributions to that objective, but that it 'is government, not companies, that should shoulder the responsibility of defining and addressing societal objectives with limited or no connection to long-term shareholder value'. In addition, CII argues that the Roundtable's statement ignores/downplays the role of markets. 'While we appreciate that CEOs do not like to feel constrained and subject to market forces, nothing in the BRT statement will change this real-world dynamic of public equity markets'.

'While it is important for boards and management to have and articulate long-term vision, and sustain focus on the long-term strategy where they have strong conviction, a fundamental strength of the U.S. economy has been and continues to be efficient allocation of equity capital. If "stakeholder governance" and "sustainability" become hiding places for poor management, or for stalling needed change, the economy more generally will lose out' CII concludes.

[Sources: Council of Institutional Investors media release 19/08/2019; [registration required] The AFR 22/08/2019]

In Brief | IFM Investors has announced that seven major Australian infrastructure assets (including Ausgrid) have set carbon emissions targets representing emissions reductions of more than 200,000

tonnes CO_2 equivalent by 2030 – the same, according to IFM Investors, as removing almost 70,0001 cars from the road. The Guardian quotes IFM head of Australian infrastructure Michael Harma as saying that the initiative 'represents a genuine commitment, and start, to aligning our assets to the Paris Agreement, and it makes perfect business sense by reducing costs, mitigating future business risks and contributing to outcomes that our customers value'

[Sources: IFM Investors August 2019; The Guardian 26/08/2019;The SMH 26/08/2019]

Regulators

Stop Press | ASIC has released its corporate plan for 2019-2023

The Australian Securities and Investments Commission (ASIC) has released its Corporate Plan setting out how it will bolster its capabilities and deliver its own change program and strategic priorities.

The seven strategic priorities identified in the plan aim to:

- promote better corporate cultures and behaviours, in particular the values of fairness and professionalism
- address consumer harms (particularly where vulnerable individuals and communities are impacted) and improve consumer outcomes
- deter, punish and publicly denounce wrongdoing via the regulator's 'Why not litigate?' approach

In addition, ASIC says that it will prioritise and acting on/addressing the findings and recommendations of the Financial Services Royal Commission.

To achieve this, ASIC states that it will: a) expand the use of behavioural sciences, data and technology; b) position itself as a strategic and agile regulator; c) develop and use new regulatory tools and remedies (eg the new product intervention power, the design and distribution obligations and tougher penalties) and d) 'scale up ASIC' to achieve these outcomes.

Announcing the release of the plan, ASIC Chair James Shipton said 'The public expects financial firms to treat Australians fairly and live up to the expectations of the community and the law…The public expects ASIC to see that they do. If the firms or individuals we regulate do not, we have the will, the resources and the regulatory tools to hold them to account.'

The full text of the Corporate Plan is available on the ASIC website here

[Source: ASIC media release 28/08/2019]

In Brief | 'The regulatory pendulum has swung': In his speech to the risk management association APRA Chair Wayne Byres reflected on the changes that have taken place over the past five years, noting among other things the shift away from pursuit of a 'strong deregulatory agenda' towards a broader and interventionalist approach in which culture, governance and accountability are a strategic priority for the regulator. 'We are now in a world where APRA is being tasked to do more, and more assertively, than we have traditionally done' Mr Byres said 'overall there is no doubt that expectations of APRA have grown, and they have pushed us into new fields of endeavour. There is no sign that tide is going to turn soon'

[Sources: APRA Chair Wayne Byres' speech to the Risk Management Association Australia CRO Board Dinner, Reflections on a changing landscape, 26/08/2019] [registration required] The AFR 26/08/2019; [registration required] The Australian 27/08/2019; [registration required] The SMH 26/08/2019]

Financial Services

Top Story | Invest in regtech or face the consequences?

Overview | ASIC Regtech Financial Advice Files Symposium, Opening Statement by ASIC Deputy Chair Daniel Crennan QC

In his opening statement to the Australian Securities and Investments Commission (ASIC) Regtech Financial Advice Symposium, ASIC Deputy Chair Daniel Crennan called on industry to prioritise investment in regtech in order to meet regulatory, compliance and professional obligations. 'The status quo is no longer an option. ASIC expects more. Consumers expect more' Mr Crennan said.

Mr Crennan said that as the financial services system becomes larger, more complex, digitised and globalised, regulators' expectations with respect to compliance and risk remain high. He added that consumers' expectations are also rising.

ASIC's expectation, Mr Crennan said, is that 'organisations keep up'.

The price of failing to keep up?

Citing the $119.7 million in compensation (as at 30 June 2019) paid to customers who suffered loss or detriment because of non-compliant advice by financial advisers; and the uptick in ASIC's enforcement actions in the financial services sector over the past six months (as highlighted in the regulator's most recent Enforcement Report (for a summary see: Governance News 21/08/2019) Mr Crennan observed that 'we're all aware of the consequences of not keeping up, particularly relating to the provision of financial advice'.

What's required?

Mr Crennan told the conference that there is no doubt that technology is 'front and centre of financial services provision' and that in order to improve risk management and minimise compliance risks, industry 'must include the capacity to explore, test, and implement "compliance-by-design" regtech solutions'.

'It would be ideal to witness a decrease in the number of ASIC's compliance-related enforcement actions as a direct result of industry's uptake of regtech' Mr Crennan observed.

From ASIC's perspective he said that expediting supervisory tech 'for itself, as much as everyone else' is 'critically important. 'If we can lessen our own operational and delivery burdens, we can speed up our own processes and improve our own effectiveness' Mr Crennan said. In particular, ASIC is looking to build capability in behavioural sciences, data analytics and artificial intelligence as well as increasing coordination and exchange of information about regtech initiatives with other regulators. This is in line with ASIC's Four-Year Strategic Change Program, which began in 2018.

Still a 'learning exercise'

Mr Crennan said that regtech is an evolving area and that the event should be treated as a 'learning exercise'. He called on 'industry government and regulators' to 'keep an open mind and maintain an active stance on everything we come across during this Regtech Initiative series'.

What does this mean for the sector?

MinterEllison Partner Anthony Borgese applauded Mr Crennan's call for business to build 'compliance by design' regtech solutions into their business models, adding that 'developments such as afterpay and zippay, are turning credit systems on their head, and creating issues for regulators on how they should best be controlled and regulated. The next wave of crypto currency has the real potential to bypass the regulated financial systems. So Crennan is correct when he says that our financial systems are becoming larger, more complex, digitised and globalised. And so the status quo is no longer an option. In fact keeping the status quo will mean that the regulatory systems will go backwards fast'.

Mr Borgese went on to observe that failure to have appropriate systems in place was highlighted in the Financial Services Royal Commission's Final report as a contributing factor in a number of issues identified over the course of the hearings (eg in relation to the widespread fee for no service issue) and that Mr Crennan's speech further underlines the imperative for industry to take steps to address these issues.

[Note: For insights into how technology can assist in implementing the Commission's Recommendations see: FSRC Final Report: technology and data implications]

[Source: Opening statement by Daniel Crennan QC, Deputy Chair, Australian Securities and Investments Commission at the ASIC Regtech Financial Advice Files Symposium, 22/08/2019]

Top Story | Moving on FSRC broker reforms: The government is consulting on draft legislation to implement a best interests duty for mortgage brokers and broker remuneration reform

Treasury has released an exposure draft Bill and Regulations for consultation, which propose to implement the government's response to Financial Services Recommendation 1.2 (best interests duty) and Recommendation 1.3 (mortgage broker remuneration)

Key Takeouts

- The draft Bill and Regulations propose to implement the government's response to Financial Services Royal Commission recommendations 1.2 (best interests duty for mortgage brokers) and 1.3 (mortgage broker reform).
- The draft legislation proposes to make changes to mortgage broker remuneration by: a) requiring the value of upfront commissions to be linked to the amount drawn down by borrowers instead of the loan amount; b) banning campaign and volume-based commissions and payments; and c) capping soft dollar benefits. The regulations limit the period over which commissions can be clawed back from aggregators and mortgage brokers to two years and prohibit the cost of clawbacks being passed on to consumers.
- Remuneration structures for mortgage brokers, including upfront and trail commissions, will be reviewed in three years' time by the Council of Financial Regulators and the Australian Competition and Consumer Commission (ACCC).
- Consultation on the proposed reforms will close on 4 October. The proposed date on which the reforms will come into force is 1 July 2020.

On the 26 August an exposure draft Bill — [draft] National Consumer Credit Protection Amendment (Mortgage Brokers) Bill 2019 — and exposure draft Regulations were released for consultation. The proposed legislation proposes to implement the government's response to two recommendations of the Hayne Commission, namely recommendations 1.2 (best interest duty for mortgage brokers) and 1.3 (broker remuneration reform).

[Note: The government's initial response to the Financial Services Royal Commission Final Report Recommendations released in February specified, with respect to recommendation 1.3, that the government will not move to implement a 'borrower pays' model (pending the outcome of a review) but would move forward with other recommended changes to broker remuneration. The government's recently released implementation roadmap for implementing the Commission's recommendations reiterated that recommendation 1.3 will be implemented in line with the government's initial response. For a summary of the implications of the government's initial response to implementing recommendations relating to brokers see: FSRC Final Report: Mortgage broking implications. For a summary of the government's implementation roadmap/timelines for implementing the Commission's recommendations see: Governance News 21/08/2019).]

Timeline

Consultation on the draft legislation will close on 4 October. The proposed reforms are planned to come into force on 1 July 2020.

According to the government's 'implementation roadmap' which sets out timelines for implementing the government's response to the Hayne Commission's recommendations, the government intends to consult and introduce the legislation by the end of 2019 (see: Governance News 21/08/2019).

What's proposed? Some key points

Schedule 1 to the draft Bill proposes to amend the National Consumer Credit Protection Act 2009 (NCCP Act) to:

1. **require mortgage brokers to act in the best interests of consumers (in line with the government's response to recommendation 1.2):** Mortgage brokers would be required to act in the best interests of consumers in relation to credit assistance in relation to credit contracts and, where

there is a conflict of interest, mortgage brokers would be required to give priority to consumers in providing credit assistance in relation to credit contracts.

2. **address conflicted remuneration for mortgage brokers and 'mortgage intermediaries such as aggregators' (in line with the government's response to recommendation 1.3):** Mortgage brokers and mortgage intermediaries would be banned from accepting conflicted remuneration, and employers, credit providers and mortgage intermediaries would be prohibited from giving conflicted remuneration to mortgage brokers or mortgage intermediaries.

[Note: In his final report, Commissioner Hayne writes (at p72) that the best interests obligation should not apply to aggregators 'who have no direct relationship with the borrower and play no role in the selection or recommendation of the loan. See: Financial Services Royal Commission Final Report Volume 1]

Schedule 1 to the draft Bill proposes to amend the National Consumer Credit Protection Act 2009 (NCCP Act) to: a) require mortgage brokers to act in the best interests of consumers (in line with the government's response to recommendation 1.2); and b) address conflicted remuneration for mortgage brokers and 'mortgage intermediaries such as aggregators' (in line with the government's response to recommendation 1.3).

With respect to implementing recommendation 1.3, Treasurer Josh Frydenberg said that the Bill proposes to link the value of upfront commissions to the amount drawn down by borrowers instead of the loan amount; banning campaign and volume-based commissions and payments; and capping soft dollar benefits.

It's proposed that a contravention of each obligation in Schedule 1 to the Bill will attract a civil penalty (a maximum of 5,000 penalty units per contravention) and that the existing enforcement regime in the NCCP Act will also apply in relation to a contravention of the obligations.

Additionally, the draft Regulations propose to limit claw back commissions payable to brokers to two years and prohibit the passing on of the costs associated with this to consumers.

Mr Frydenberg said that remuneration structures for mortgage brokers, including upfront and trail commissions, will be reviewed in three years' time by the Council of Financial Regulators and the Australian Competition and Consumer Commission (ACCC).

A duty to act in the best interests of the consumer? A 'principles based approach'

The explanatory memorandum states that the 'duty to act in the best interests of the consumer in relation to credit assistance is a principle-based standard of conduct that applies across a range of activities that licensees and representatives engage in…what conduct satisfies the duty will depend on the individual circumstances in which credit assistance is provided to a consumer in relation to a credit contract'.

This approach is consistent, the explanatory memorandum states, with the Financial Services Royal Commission's final report recommendation, in that it does not prescribe conduct that will be taken to satisfy the duty in specific circumstances. 'It is the responsibility of mortgage brokers to ensure that their conduct meets the standard of "acting in the best interests of consumers" in the relevant circumstances' the explanatory memorandum states.

[Note: Commissioner Hayne discusses this point in his final report at p72 where he comments 'As ASIC submitted, the content of the duty is best expressed "as a broad statement of principle". ASIC's proposed drafting of the obligation as "to act in the best interests of the consumer [I might prefer "loan applicant"] in the selection and arranging of loans' goes a long way to capturing the heart of the relevant ideas. Imposing this obligation would give statutory recognition to what borrowers currently expect of brokers.' See: Financial Services Royal Commission Final Report Volume 1]

Who do the proposed changes apply to?

The new law imposes obligations on mortgage brokers and mortgage intermediaries.

For the purposes of the proposed new law:

- a mortgage broker 'can be either a licensee or a credit representative of a licensee that carries on a mortgage broking business'. The new requirements also apply to 'representatives of credit representatives that are mortgage brokers'

- a mortgage intermediary 'is either a licensee or a credit representative of a licensee that acts as an intermediary in relation to mortgages'

The explanatory memorandum stipulates that these definitions are 'intended to only capture those businesses that would ordinarily be described as a mortgage broking or mortgage intermediary businesses. In particular, the definitions of both terms are not intended to extend to credit providers where they are providing credit assistance in relation to their own products rather than providing broking or intermediary services'.

Purpose/objective of the proposed reforms?

The explanatory memorandum states that the changes are intended to 'bring the law into line with what consumers expect — that any advice provided by a mortgage broker services the consumer's interests first and foremost'. The objective of the new law is to 'improve consumer outcomes' by requiring mortgage brokers to act in the best interests of their clients and by reducing the potential for conflicts of interests to impact the advice consumers receive from mortgage brokers.

Announcing the consultation Treasurer Josh Frydenberg echoed this saying, 'Mortgage brokers play an important role in promoting good consumer outcomes and competition in the home loan market. Mortgage brokers have a strong presence in the home loan market accounting for close to 60 per cent of home loans. The implementation of the best interests duty will bring the law in line with what consumers expect of mortgage brokers'.

[Sources: Treasurer Josh Frydenberg media release 26/08/2019; Treasury media release 26/08/2019; Exposure Draft Bill; Exposure Draft Regulations; Exposure Draft Explanatory Memorandum; Exposure Draft Explanatory Statement; [registration required] The AFR 26/08/2019]

Industry response?

The Age quotes Choice Head of campaigns Erin Turner as saying that the proposed wording of the best interests duty looked 'strong' at first glance and it should encourage better quality advice from brokers, which may include telling customers not to borrow at all in some cases. 'It should mean that you're more likely to get a better deal - a better interest rate or a better quality loan' Ms Turner is quoted as saying.

Managing Director of the Finance Brokers Association of Australia (FBAA) Peter White is quoted as saying that the FBAA does not oppose the introduction of a best interests duty in principle, but that the duty should 'be different to the duty imposed on financial advisers.'

[Source: [registration required] The Age 27/08/2019]

Financial advisers have reportedly raised concerns that the proposed new disciplinary body to be established in line with FSRC recommendation 2.10 is excessive

Context: Financial Services Royal Commission recommendation 2.10 recommended that new disciplinary system — requiring all financial advisers who provide personal financial advice to retail clients to be registers; providing for a single central disciplinary body; requiring Australian Financial Services Licence (AFSL) holders to report serious compliance concerns to the disciplinary body; and allowing clients and other stakeholders to report information about the conduct of financial advisers to the disciplinary body — be established for financial advisers. The government has said it intends to consult on legislation to implement the recommendation by the end of 2020 (see: Governance News 21/08/2019.)

Concerns? The AFR reports that a number of peak bodies representing financial advisers have raised concerns that the creation of a new disciplinary body (as recommended by the Hayne Commission) appears to overlap with the creation of a new body to enforce compliance with the industry code of ethics, currently under considered by the Australian Securities and Investments Commission (ASIC).

Code monitoring is a requirement of the FASEA professional standards legislation, which came into force in 2017, and requires every financial adviser to belong to a 'code monitoring scheme' by January 1. Six peak bodies – the Financial Planning Association of Australia (FPA), the Association of Financial Advisers (AFA), FINSIA, the SMSF Association, Stockbrokers and Financial Advisers (SFA), and Boutique Financial Advisers – made an application earlier this month for ASIC approval for a new entity, Code Monitoring Australia (CMA), to conduct this role.

CEO of the Association of Financial Advisers Philip Kewin is quoted as saying that the proposed new body 'looks like a duplication…If the professional standards are set up with a code monitoring body, which is what we are heading towards, does this new single body oversee ASIC and FASEA? And if so, isn't that additional red tape which the government is trying to remove?'

CEO of the Financial Planning Association of Australia Dante de Gori, reportedly said it was unclear whether Code Monitoring Australia would become the new single disciplinary body, or whether it would be something else. 'There is uncertainty about it, we don't know what the future will be…We welcome the government proceeding with code monitoring but we need clarity what it means beyond 2020…Creating CMA has been a lot of work over [the] last two years, it's taken a lot of time and effort to make sure we can adhere to the requirement imposed on all advisers.'

Hope for extension of time to meet new professional qualification requirements? Reportedly advisers are also seeking an extension of time for financial advisers to meet new qualification requirements. The ASA and FPA have reportedly been advocating for a 12-month extension for completing the exam to December 31, 2021, and a 24-month extension for completing a graduate diploma to December 31, 2025.

Further, the AFR reports that advisers are also hoping that FASEA will exercise its discretion to enable experienced advisers to be given credit for courses and continuing professional development they have undertaken in the past.

[Source: [registration required] The AFR 26/08/2019]

First ASIC FSRC case study: ASIC has commenced proceedings against NAB in connection with (alleged) misconduct identified by the Financial Services Royal Commission

Key Takeouts

- The Australian Securities and Investments Commission has commenced proceedings in the Federal Court against the National Australia Bank (NAB). The proceedings relate to conduct identified during the Financial Services Royal Commission.
- ASIC alleges that, between 3 September 2013 and 29 July 2016, NAB accepted loan information and documentation from third-party introducers who did not hold an Australian Credit Licence (ACL) in breach of requirements under the National Consumer Credit Protection Act 2009 (NCCP Act).
- ASIC is asking the Court to find that NAB breached the NCCP Act and to impose a civil penalty on NAB for doing so. The maximum penalty for one breach of s31(1) of the National Credit Act, during the time of contravention, was 10,000 penalty units, or $1.7 to $1.8 million.
- On 25 March 2019, NAB announced that it will be terminating the Introducer Program on 1 October 2019.

The Australian Securities and Investments Commission (ASIC) has commenced proceedings in the Federal Court against National Australia Bank (NAB) for (alleged) breaches of the law arising from (alleged) failures in connection with its Introducer Program (loan referral program).

Context: Financial Services Royal Commission case study

ASIC notes that the (alleged) misconduct identified in the proceedings was detailed in Volume 2 of the Commission's Final Report (p1-16). It was also the subject of ASIC's administrative action against former NAB Branch Manager Rabih Awad (loan fraud) and ASIC's criminal prosecution and administrative action against former NAB Branch Manager Mathew Alwan (loan fraud).

[Note: ASIC's latest enforcement update — Report 625 ASIC enforcement update January to June 2019 — flagged that ASIC intends to 'prioritise' work on the 14 investigations launched in the wake of the Financial Services Royal Commission as well as significant number of other investigations in Australia's major financial institutions. Media reports suggest that there could be 50+ court actions launched before the end of the year. For a summary of ASIC's report see: Governance News 21 August 2019]

Details

ASIC alleges that between 3 September 2013 and 29 July 2016, NAB accepted information and documents in support of consumer loan applications from third party introducers who were not licensed to engage in credit activity.

ASIC alleges NAB:

- breached s31(1) of the National Consumer Credit Protection Act 2009 (NCCP Act) which prohibits credit licensees from conducting business with parties engaging in credit activity without an Australian credit licence (ACL)
- breached its obligations under s47 of the NCCP Act requiring it to engage in credit activities efficiently, honestly and fairly and to comply with the Act.

The proceedings relate to the conduct of 16 bankers accepting loan information and documentation from 25 unlicensed introducers in relation to 297 loans.

ASIC is asking the Court to find that NAB breached the National Credit Act and to impose a civil penalty on NAB for doing so. The maximum penalty for one breach of s31(1) of the National Credit Act, during the time of contravention, was 10,000 penalty units, or $1.7 to $1.8 million.

[Note: For further detail see: The Concise Statement and Originating Process]

The AFR quotes ASIC Deputy Chair (Enforcement) Daniel Crennan QC as commenting the 'conduct we say NAB engaged in — the receipt of information about prospective borrowers from introducers - leads to a dangerous situation where prospective borrowers ability to repay the loan is immediately put into question…The licensing regime is driven by consumer protection, and the imposition of obligations by the legislature was intended to protect consumers - which in this case we say failed.'

Mr Crennan reportedly went on to say that the 'it is a case against the bank for its failure to have systems in place, such that an unlicensed introducer was put in a position where they could provide - and this was accepted - information and documentation, including home loan applications and payslips…It was a broad suite of conduct by the introducers that was impermissible, which was able to happen because of NAB's failure to observe its obligation as the licensee.'

NAB response

In a statement, NAB Commercial Sharon Cook said that the lender 'take this legal action seriously and will now carefully assess the allegations. Throughout the Royal Commission we heard clearly that our actions need to change to meet the expectations of our customers and the community. That's why in March this year we announced we would be ending referral payments to introducers [on 25 March 2019, NAB announced that it will be terminating the Introducer Program on 1 October 2019]. We also established a remediation program in November 2017 to assist impacted customers.'

[Sources: ASIC media release 23/08/2019; NAB media release 23/08/2019; [registration required] The AFR 23/08/2019]

Consumer Credit Insurance (CCI) remains a focus for ASIC: ASIC has announced that Allianz will refund $8m in consumer credit insurance premiums and fees following an ASIC investigation, ASIC has also flagged that it has commenced investigations into a number of other entities

Key Takeouts

- The Australian Securities and Investments Commission (ASIC) has announced that Allianz Australia Insurance Limited (Allianz) will refund over $8 million in consumer credit insurance (CCI) premiums and fees including interest to more than 15,000 consumers following an ASIC investigation.
- ASIC's statement (a summary of which is below) sets out the details of the remediation program covering certain CCI products issued by Allianz
- ASIC expects that Allianz will write to all affected consumers about their refund offer from October 2019. Allianz will stop selling CCI policies from 30 September

- The statement makes clear that the remediation outcome in this case is not an isolated one, ASIC Commissioner Sean Hughes commenting, 'This remediation outcome is only one of many examples where CCI has failed consumers'. ASIC's recent review of the sale of CCI has so far resulted in refunds of over $100 million
- ASIC says it has also commenced investigations into a number of entities that have been involved in mis-selling CCI to consumers
- ASIC is currently consulting on a proposal to ban the sale of CCI and direct life insurance through unsolicited telephone calls (see: Governance News 24/07/2019)

The Australian Securities and Investments Commission (ASIC) has announced that following an ASIC investigation, Allianz Australia Insurance Limited (Allianz) will refund over $8 million in consumer credit insurance (CCI) premiums and fees including interest to more than 15,000 consumers.

Broader context: ASIC's focus on CCI

ASIC notes that the action follows the release of the regulator's review of the sale of CCI by lenders —Report 622 Consumer credit insurance: Poor value products and harmful sales practices (REP 622) (see Governance News 17/07/2019) — and is part of the regulator's broader priority to address harms and unfair practices impacting consumers in insurance. The review has resulted in refunds of over $100 million due to more than 300,000 affected consumers so far.

ASIC adds that it has commenced investigations into a number of entities that have been involved in mis-selling CCI to consumers.

Further, ASIC is also consulting on a proposal to ban the sale of CCI and direct life insurance through unsolicited telephone calls (see: Governance News 24/07/2019). Consultation on the proposed changes closes on 29 August.

ASIC Commissioner Sean Hughes commented, 'Disappointingly, our work on the sale of CCI has highlighted widespread mis-selling and poor product design. This remediation outcome is only one of many examples where CCI has failed consumers. We expect insurers to cease to sell insurance products that provide little or no value…We need a financial system that is fair. Insurers and other financial institutions need to rise to the challenge and embed the principle of fairness into their businesses to ensure we do not see any further instances of this kind of poor value product being pushed on to consumers'.

Details

ASIC writes that Allianz's refund relates to the sale of cover to consumers who were ineligible to make a claim for unemployment or disability; the sale of death cover to customers under 21 years of age who were unlikely to need that cover; and the charging of fees to customers who paid premiums by the month without adequate disclosure.

To address these issues, Allianz will:

- **for ineligible sales of unemployment and disability cover**: refund premiums charged plus interest for active, cancelled or lapsed policies sold between 1 January 2011 to 31 December 2018; reassess all withdrawn and declined claims where the consumer was ineligible for the policy at the time of sale; invite consumers to submit a claim if they have not already done so and pay valid claims plus interest; and continue to honour active policies and not rely on employment eligibility criteria as a basis to decline an unemployment or disability claim.
- **for sales of death cover to customers under 21 years of age:** refund all premiums charged plus interest for active, cancelled or lapsed policies sold between 1 January 2011 to 31 December 2018; and preserve existing death cover for active policyholders on current terms without charging for it; for monthly policy payment customers, refund all administration fees and loading charged plus interest; and correct any future direct debit amounts.

ASIC's statement adds that Allianz will stop issuing new CCI policies from 30 September 2019. It will continue to fulfil its obligations to existing CCI policyholders.

ASIC expects that Allianz will write to all affected consumers about their refund offer from October 2019.

[Source: ASIC media release 27/08/2019]

An opportunity for advisers? ASIC's report into financial advice has identified cost, distrust of financial advisers and the difficulty of engaging with the industry as key barriers to consumers seeking financial advice

Report Overview | ASIC Report 627, Financial advice: What consumers really think

The Australian Securities and Investments Commission (ASIC) has released a report summarising the results of independent research (focus groups and an online survey) into consumer experiences/attitudes towards financial advice and the advice industry.

Some Key Points

- Though 27% of survey respondents said that they had received financial advice in the past, only 12% had done so in the past 12 months. Over 40% of respondents (41%), indicated that they intend to get financial advice 'in the future' and 25% said that they intend to do so in the next 12 months.
- Consumers most commonly seek financial advice for investments such as shares and managed funds, retirement income planning, growing their superannuation and budgeting or cash flow management.
- The research found that though only 1% of respondents had used digital advice (also called robo advice), 19% of research participants said they were open to getting digital advice (once the concept of robo advice was explained to them)

Barriers to getting financial advice

The research found that though 79% of consumers believe financial advisers can offer significant expertise on financial matters, many (20%) don't seek advice due to high costs, significant distrust of the industry and a perception that financial advice is only for the wealthy.

- **Cost:** The key barrier to seeking financial advice was the cost with 64% of online survey participants agreeing that financial advisers are too expensive and only 29% of the online survey participants agreed that financial advisers provided good value for money
- **Distrust of financial adviser**s: 49% of respondents agreed that financial advisers were more interested in making themselves rich than in helping their customers and 37% agreed that financial advisers did not generally have the customer's best interests at heart.
- **Difficulty of engaging with the industry**

According to the report, these factors do not operate independently but rather distrust of financial advisers operated to influence consumer perceptions of the cost of advice and how difficult it is to engage with the industry.

- **Other barriers identified in the report include:** disengagement, feeling vulnerable at the thought of seeing a financial adviser, not wanting to make lifestyle changes, and perceptions of financial advice as being risky or 'only for wealthy people' (49% of participants said they believe that their income and assets were too limited for it to be worth using a financial adviser).

Opportunity for advisers? ASIC Commissioner Danielle Press observed that 'The good news for industry is that consumers who had recently received financial advice had more positive attitudes towards financial advisers than those who had not. Moreover, even limited knowledge of industry reforms such as FOFA (Future of Financial Advice) appears to have improved consumer attitudes towards the sector. So, it is even more important for industry to get on board with the reforms'.

Ms Press added that 'Financial advisers have an important role to play in helping consumers improve their financial position, and there is a real opportunity for the advice industry to rebuild that trust by reorienting itself and putting consumers at the heart of its services'.

Next steps

1. ASIC plans to conduct further research in 2020–21 to explore whether there is a problem with unmet advice needs in Australia. The research will examine: a) the state of the financial advice industry; b) the demand for advice (including unmet advice needs); c) the supply of advice; d) the gaps (if any) between supply and demand; and e) what measures may be required (if any) to reduce gaps between supply and demand.

2. In addition, ASIC will conduct further consumer research (building on ASIC report 614: Mind the gap — consumers confusing different types of financial advice released in March 2019) which revealed gaps in consumer awareness and comprehension of the distinction between general and personal advice. 'Later' in 2019, ASIC will commission research to identify a more appropriate label for general advice or different labels for general advice (given in different circumstances) and test the effectiveness of different versions of the general advice warning.

[Sources: ASIC media release 26/08/2019; ASIC Report 627, Financial advice: What consumers really think; [registration required] The Australian 27/08/2019; Independent Financial Adviser 27/08/2019]

ASIC is monitoring the shift away from grandfathered commissions and is due to report to the federal government on the transition by mid-2021

Key Takeout

The Australian Securities and Investments Commission (ASIC) has commenced its investigation into the financial advice industry's shift away from grandfathered commissions and will provide a detailed report to the federal government on the transition by mid-2021

The Australian Securities and Investments Commission (ASIC) has commenced investigating the progress of the financial advice industry's transition away from grandfathered conflicted remuneration arrangements.

ASIC said it will also investigate any impediments to this transition, and the extent to which benefits are being passed on to affected clients.

ASIC said that it will conduct both quantitative and qualitative reviews.

- For the quantitative study, ASIC will conduct a survey of entities known to pay grandfathered conflicted remuneration to Australian financial services (AFS) licensees or their representatives and require them under notice to provide data: initially for a 12-month period (from 1 July 2018 to 30 June 2019), and thereafter on a quarterly basis for the review period (for example, reporting for the period from 1 July to 30 September 2019 will be in October 2019).

- The qualitative review will include a smaller sample of entities that pay and receive grandfathered remuneration. This will involve more detailed engagement and analysis during the review period.

ASIC will analyse the information from both reviews and report to the Treasurer by 30 June 2021. The report will also be released publicly. ASIC expects to provide an update on its investigation to the Treasurer and industry as appropriate during the review period.

Treasury directed ASIC to undertake the investigation following the government's commitment to end the practice by 1 January 2021.

Context

- In its final report, the Financial Services Royal Commission recommended an end to the grandfathering of conflicted remuneration for financial advice as soon as practicable (recommendation 2.4).

- Following consultation, on 1 August 2019, Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Bill 2019 (which proposes to ban the grandfathering of conflicted remuneration paid to financial advisers) was introduced into the House of Representatives. The Bill has progressed to second reading stage. For a summary, see: Governance News 07/08/2019.

[Source: ASIC Media release 21/08/2019]

Possible High Court Challenge?

The Australian reports that the regulator's inquiry comes as the Association of Independently Owned Financial Professionals (AIOFP) prepares to lodge a High Court action against a ban on grandfathered commissions, on the basis that under the constitution, the commissions cannot be legally acquired as a form of property or asset.

[Source: [registration required] The Australian 22/08/2019]

AFCA to 'name and shame'? ASIC has approved an AFCA rule change to enable the naming of firms in determinations

The Australian Securities and Investments Commission (ASIC) has approved changes to the Australian Financial Complaints Authority (AFCA) Rules to allow the scheme to name financial firms in published determinations. Consumers who are party to a complaint will continue to be anonymised in all determinations.

Background

AFCA applied for approval to change their Rules to enable identification of firms following public consultation.

[Note: On 31 May 2019, AFCA conducted a public consultation on Rules changes to enable the scheme to name firms in determinations. Consultation closed on 20 June.]

ASIC says that it took into account stakeholder feedback in approving the rule change.

Rationale? ASIC writes that naming firms in AFCA determinations is part of a broader set of reforms aimed at increasing transparency in financial services. This includes parliament giving ASIC power to collect and to publish internal dispute resolution (IDR) data at firm level.

[Note: ASIC's consultation on updates to internal dispute resolution (IDR) policy settings and data reporting framework (CP 311) closed on 9 August 2019. For a summary see: Governance News 22/05/2019. ASIC says that its review of IDR policy and regulatory guidance is expected to be completed by the end of 2019.]

'ASIC's view is that naming firms in determinations can help identify conduct or market problems within firms or affecting specific products or services, as well as highlighting where firms have done the right thing. It will also enhance transparency and accountability of firms' performance in complaints handling and of AFCA's own decision-making' ASIC states.

ASIC notes that the UK Financial Ombudsman Service has been naming firms in published determinations since 2013.

In a statement welcoming ASIC's decision, AFCA Chief Ombudsman and CEO David Locke said AFCA is committed to being open, transparent and accountable to the public. 'AFCA plays an important public role and we recognise that transparency in our data and decisions is essential to rebuilding trust in the financial sector. We already publish decisions on our website, but we have been unable to name the financial firms involved. We welcome ASIC's approval to change our Rules, which will allow us to now name financial firms in decisions we publish on our website. This is an important change, and the public will now be able to access increased information about the actions of financial firms.'

Next steps? To support the new Rules, AFCA will shortly be issuing updated operational guidelines which set out examples of the circumstances in which a determination naming a financial firm would not be published. This includes where naming may expose confidential information about a firm's systems or policies.

AFCA has said it is working with ASIC to determine the start date for the naming of financial firms.

[Sources: ASIC media release 26/08/2019; AFCA media release 26/08/2019; Investor Daily 26/08/2019]

ASIC product intervention power consultation: ASIC proposes to make market-wide product intervention orders relating to the issue and distribution of OTC binary options and CFDs

Overview | ASIC Consultation, Product intervention: OTC binary options and CFDs (CP 322), ASIC Report, Consumer harm from OTC binary options and CFDs (REP 626)

Key Takeouts

- ASIC is concerned that the issue of OTC binary options and CFDs to retail clients has resulted in, and is likely in future to result in, significant detriment, including significant financial losses.
- ASIC notes that despite its 'strong and frequent regulatory action, using a range of regulatory tools' to address concerns about OTC binary options and CFD, retail clients continue to suffer significant detriment.
- To address this harm, ASIC proposes to make market-wide product intervention orders relating to the issue and distribution of OTC binary options and CFDs

The Australian Securities and Investments Commission (ASIC) has released a consultation paper on proposals to use its product intervention power to address significant detriment to retail clients resulting from over-the-counter (OTC) binary options and CFDs.

ASIC's concerns

Report 626 (which accompanies ASIC's consultation paper) describes the harm to consumers ASIC has observed.

Binary options: ASIC considers that binary options have resulted in, and are likely in future to result in, significant detriment to retail clients because: a) most retail clients who trade binary options lose money (ASIC observed that 80% of clients who trade binary options lose money); b) binary options have a negative expected return, resulting in significant market-wide financial losses; c) there is a high likelihood of cumulative losses trading binary options; and d) they have characteristics 'akin to gambling' — the inherent structural design flaws of binary options are confusing and make them unsuitable as an investment or risk management product for retail clients.

CFDs: ASIC considers that CFDs have resulted in, and are likely in future to result in, significant detriment to retail clients because: a) most retail clients who trade CFDs lose money (72% of clients who trade CFDs lose money and 63% of clients who trade margin FX lose money); b) trading CFDs has an inherent risk of significant losses due to the product's high leverage ratios, including losses which can exceed a retail client's initial investment; c) fees and costs lack transparency, are magnified by leverage and can quickly and significantly deplete a retail client's investment; and d) confusing and unclear pricing methodologies can lead to the sale to retail clients of CFDs that are misaligned with their needs, expectations and understanding.

Further, in 2017 and 2018, over 225,000 new clients were given inducements for opening an account to trade binary options or CFDs. These offers, ASIC observes, can attract financially vulnerable consumers who underestimate the high risks of these products.

In addition, the ASIC notes that complaints received by ASIC and AFCA about binary options and CFDs have accelerated since 2017. In 2019 they accounted for over one third of markets-related complaints - disproportionately large for the financial markets sector.

ASIC's proposed action

ASIC proposes to:

1. make a market wide product intervention order in force for 18 months prohibiting the issue and distribution of OTC binary options to retail clients to 'address the significant detriment'. ASIC proposes that the product intervention would take effect 10 business days after the day on which the legislative instrument is registered.
2. make a market-wide product intervention order, in force for 18 months, which would impose eight conditions on the issue and distribution of OTC CFDs to retail clients namely: 1) impose leverage ratio limits; 2) implement a standardised approach to automatic close outs of retail client positions; 3) protect against negative balances; 4) prohibit certain inducements and (5-8) require enhanced transparency of

CFD pricing, execution, costs and risks (note: The conditions on the issue and distribution of CFDs to retail clients are set out in Table 5 p46 of CP 322)

ASIC comments that its proposed approach is largely consistent with the approach taken in other jurisdictions and with the IOSCO toolkit — Report on Retail OTC Leveraged products (a guide intended to assist regulators to enhance retail client protections).

[Note: ASIC's proposals, including draft product intervention orders are detailed in Consultation Paper 322 Product intervention: OTC binary options and CFDs. ASIC's proposed actions and specific questions on which ASIC seeks feedback are listed at the end of the paper at p69-70.]

Commenting on ASIC's proposed action, ASIC Commissioner Cathie Armour said, 'For many years ASIC has taken strong action to protect consumers of binary options and CFDs, using the range of regulatory tools available to us. However, we are concerned that consumers continue to suffer significant harm from trading these products. A complete ban would prevent retail clients from losing money trading binary options. We believe binary options provide no meaningful investment or economic use, and have product characteristics similar to gambling products.'

Timing: The deadline for submissions is 1 October 2019.

Background

- ASIC released a consultation paper — CP 313 Product Intervention Power — and draft regulatory guide setting out how it plans to administer the new product intervention regime introduced in the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019 in July. Consultation closed on 7 August. See: Governance News 03/07/2019.

- ASIC released consultation paper CP 316 Using the product intervention power: Short term credit on 9 July. ASIC proposed using its new product intervention powers to target a specific short term lending model that it claims causes 'significant consumer detriment' to vulnerable customers. ASIC's preferred approach is to impose an industry wide product intervention order banning (certain) lending models which benefit from the short term credit exemption. Consultation closed on 30 July. ASIC said it anticipates making a decision on whether to make a product intervention order in relation to short term credit during the course of August 2019. For a summary see: Governance News 10/07/2019.

Related News: ASIC's proposed response may drive investors offshore?

The AFR reports that 'entrepreneur, psychologist and securities trader' Mario Pirotta claims to have trebled his money using contracts for difference (CFDs) during the past 12 months and is opposed to ASIC's proposed action on this basis. Reportedly Mr Pirotta is of the view that the focus should be on educating investors about the risks involved. He is also reportedly concerned that the proposed changes could drive investors offshore into markets with 'fewer controls, higher leverage and greater risks'. Reportedly, the CEO of Pepperstone (an online retail FX broker) Tamas Szabo agreed that the proposed changes had potential to drive investors offshore.

[Sources: ASIC media release 22/08/2019; OTC binary options and CFDs (CP 322); ASIC Report, Consumer harm from OTC binary options and CFDs (REP 626); [registration required] The AFR 22/03/2019; 23/08/2019; The SMH 22/08/2019]

ANZ Chair David Gonski has outlined some of the issues identified in ANZ's culture/governance self-assessment, and the measures the lender is implementing to address them

In a comment piece on ANZ's bluenotes website, ANZ Chair David Gonski provided some insights into ANZ's recent culture/governance self-assessment (which has not been released publicly) and the lender's plans to address the issues identified.

Why not release the full self-assessment publicly? Mr Gonski said that the self-assessment was completed, at the Australian Prudential Regulation Authority's (APRA's) request, on a confidential basis to 'ensure institutions responded in a way that was full and frank'. 'We have respected that request, as well the fact that people contributed on that basis, and will continue to do so' Mr Gonski said.

Having said this, he observed that it is appropriate that the lender 'share the actions we are taking to address issues raised in our self-assessment with our shareholders and other stakeholders'.

ANZ self-assessment: issues highlighted

Mr Gonski writes that the self-assessment highlighted 'many critical findings' across 'culture, accountability and governance' at the lender. 'We recognise there have been instances where we have failed our customers. Where this has occurred we are determined to make things right as quickly as practicable. Significant resources and priority are being given to this task' Mr Gonski writes.

Mr Gonski went on to highlight the following issues.

- Mr Gonski writes that from a cultural perspective, the self-assessment identified 'a compliant culture with strong loyalty to teams - often at the expense of the broader group. There was also a greater focus on short-term fixes and what it meant to be 'customer-centric' lacked clarity and structure'. In addition, Mr Gonski said that the self-assessment identified 'a conditioned acceptance at ANZ that it's "all too hard" or "it's the way it's always been". We have a culture where our teams do not always speak up. When permission or a process is ambiguous we can be conservative in our decision making. Often this leads to an outcome where we do nothing. This needs to change' he writes.
- He added that with respect to accountability for outcomes across ANZ 'particularly in relation to inaction or poor performance, often lacked clarity below the senior executive level'. Mr Gonski observed that this has been 'enhanced by the recent introduction of the Banking Executive Accountability Regime'.
- From a government perspective, Mr Gonski writes that the self-assessment identified 'fragmented infrastructures, drawn out processes and siloed teams. We also found aspects of non-financial risk management lacking maturity and our complexity impede swift action as well as increasing the reliance on informal networks'.

Priorities to address the issues

Mr Gonski's went on to outline a 'roadmap' for addressing the issues identified in the self-assessment/issues examined by the Financial Services Royal Commission. Key focus areas include:

- **simplification of the business**, products and processes
- **cultural change**: Mr Gonski said that the lender will implement initiatives to improve reward, coaching and accountability within the lender. He added that the bank has already announced 'wide-ranging reforms' to remuneration which will result in the replacement of individual bonuses being replaced by group incentives for the majority of employees
- **governance and accountability**: improving how 'we are held to account as well as how we manage and execute change' including the establishment of a Royal Commission & Self-Assessment Oversight Group to oversee and support our integrated response
- **remediation**: the expansion of the specialist customer remediation team to 'significantly improve the time it takes us to investigate issues as well as when customers receive their payments'. Mr Gonski said that ANZ already has almost 500 specialists focussed on remediation and that number is expected to continue to increase.
- **management of operational risk** (including increased focus on non-financial risks in the Australian retail and commercial business)

Board oversight

Mr Gonski also identified three areas requiring additional board 'involvement' namely: 'short-termism', complexity and accountability.

'We are determined the Board will improve the way it questions management - and itself - in relation to the question of our long-term ambitions. While it is noted many Australian institutions like us have a tendency to focus on the short-term, that is no excuse' Mr Gonski writes.

With respect to complexity and accountability, Mr Gonski said that management will report quarterly to the Board on progress in relation to the actions in the roadmap to enable the board to keep pace and provide effective oversight of management's work and progress.

In addition, Mr Gonski said there will be a detailed review, of the Board's charter and the charters of its principal Board Committees to ensure they provide clarity to the Board, management, and external stakeholders around the involvement of directors in the specific matters raised in the self-assessment and the roadmap. Mr Gonski said that the process will eb completed 'including making any necessary changes, by the end of this calendar year', adding that he would provide an update at the Annual General Meeting.

Success Measures

With respect to measuring success of the actions identified, Mr Gonski identified a number of success indicators including:

- 'marked improvement' in employee surveys and culture audits
- improvement in time taken to resolve customer complaints
- higher net promoter score
- material reduction in significant breach reporting over time
- staff will report improved clarity of organisational expectations and they will feel leaders are being held to account

Mr Gonski added that 'there is a significant amount of work ahead and the ultimate measure of success will be the removal by APRA of the additional capital overlay'.

[Sources: ANZ bluenotes 22/08/2019; [registration required] The AFR 22/08/2019; The SMH 22/08/2019; InvestorDaily 23/08/2019; [registration required] The Australian 23/08/2019; MyBusiness 23/08/2019]

Pushing ahead with reform of the financial services sector: Senator Jane Hume has provided an update on the government's plans for regulatory reform. Among other things, Ms Hume called on the superannuation sector to be more proactive in addressing known issues impacting member outcomes

Overview | Senator Jane Hume's address to the Financial Services Council Summit

In her address to the Financial Services Council Summit, Assistant Minister for Superannuation, Financial Services and Financial Technology Jane Hume spoke about: a) the government's progress towards implementing the recommendations of the Financial Services Royal Commission; b) reform of the superannuation sector; c) new professional, ethical and education requirements for financial advisers; d) the government's commitment to promote innovation/support the FinTech sector; and e) the consumer data right.

Some Key Points

- **The government will continue to prioritise the implementation of the Financial Services Royal Commission's recommendations**. Ms Hume said that over the next 18 months, these reforms 'will dominate Treasury's legislative program, with the work required equivalent to almost three-quarters of its current program. For comparison, the Budget this year was equivalent to 15 per cent of Treasury's legislative program' Ms Hume said.
- **Superannuation reform:** Ms Hume said that the government is moving forward with previously announced superannuation reforms for the benefit of members, including the Putting Members Interests First Bill.

[Note: Ms Hume appears to be a referring to Treasury Laws Amendment (Putting Members' Interests First) Bill 2019 which proposes to amend the Superannuation Industry (Supervision) Act 1993 to prevent trustees from providing insurance on an opt out basis to members who are under 25 years old and begin to hold a new product on or after 1 October 2019, and to members who hold products with balances below $6000. The Bill is currently before the House of Representatives having been referred to The Senate Standing Committee on Economics. The Standing Committee recommended that the government change the proposed date of commencement to 1 December 2019 and that subject to this, that the Bill be passed. See: Treasury Laws Amendment (Putting Members' Interests First) Bill 2019 [Provisions] Report July 2019.]

Call for the sector to be more proactive in addressing known issues: Further to this, Ms Hume observed that some funds have already taken action ahead of the passage of the Bill. 'Australian Super was the first to recognise that young people were being given a bad deal. They have already made insurance for under 25s opt-in. But other funds have been slow to act'. This is indicative, Ms Hume said of a broader issue within the industry. 'Why isn't the industry taking action itself on long-standing problems we all know are there, instead of waiting to be dragged kicking and screaming by Government towards a solution?' Ms Hume asked. Ms Hume went on to say that government plans to 'reframe the superannuation system so that it works for members' including by acting on the Financial Services Royal Commission recommendations. She observed that 'If trustees are meeting the presumption of their title and the expectations of members, they will be at the forefront of these changes, leading the way, and will not have to be dragged kicking and screaming to member's best interests'.

- **New education, professional and ethical requirements for financial advisers — the government is considering industry 'concerns'**: Commenting on the new requirements — ie requirements for advisers to meet approved educational qualifications; complete a FASEA approved exam and comply with a Code of Ethics — Ms Hume said she was 'well aware that financial advisers and industry representatives have concerns' about their capacity to meet the requirements, even with transitional arrangements in place. She added that the government recognises that 'it is important to strike the right balance between the need to improve the professional standards of advisers operating in the industry, but also recognising that many of these advisers need to balance work, study and family commitments. The Government is listening to your concerns and is carefully considering how to proceed'.
- **Fintech:** Ms Hume said that the government is committed to building a competitive, innnovative FinTech sector as is evidenced by the government's investment/actions to support the sector to date. She added that the government intends to continue its strong support in the coming year. Ms Hume said that, as the first FinTech Minister, she will be the 'FinTech sector's advocate in the ministry' and work with her colleagues to ensure access to capital and skills for FinTech businesses. Ms Hume said that in the coming weeks, the government will re-introduce legislation for a Comprehensive Credit Reporting regime, which will give lenders access to data to make a more accurate assessment of a borrower's true credit position and their ability to pay a loan. In addition, she said that the government is working to deliver an 'enhanced regulatory sandbox; which once implemented will allow more businesses to test a wider range of new financial products for 24 months, prior to seeking the appropriate licenses from ASIC.

[Note: The government is consulting draft legislation that proposes to a implement mandatory comprehensive credit reporting regime. Consultation will close on 5 September. For a summary see: Governance News 21/08/2019]

- **Open Banking:** Ms Hume said that progress to the February launch of Open Banking is well advanced. She added that the Australian Competition and Consumer Commission (ACCC) will shortly issue the 'lock-down' version of the Rules governing the system - and the Data Standards Body has already issued the implementation draft of the technical standards. Ms Hume said that she will share more updates on the Consumer Data Right as the rollout progresses.

Ms Hume concluded by saying that restoring trust in the financial system is a 'key part' of the government's economic plan and that she looks forward to working with industry to ensure consumers are 'engaged and confident' in the system and to ensuring financial institutions are providing the products and services are needed. 'I look forward to working with you towards a system that is supported by an efficient and effective regulatory framework, one that allows for innovation and competition' Ms Hume said.

[Source: Assistant Minister for Superannuation, Financial Services and Financial Technology Jane Hume, Address to the Financial Services Council Summit, 27/08/2019]

IOOF update on APRA licence conditions and board renewal

IOOF Holdings Ltd (IOOF) has provided an update to the market on the licence conditions imposed by the Australian Prudential Regulation Authority (APRA).

IOOF said an independent review of its compliance with the APRA licence conditions imposed in December 2018, has reported that all 145 of the actionable items required for validation by 30 June 2019 have been completed.

According to the independent review, the 4 actionable items relating to the implementation of the Office of the Superannuation Trustee, which were outstanding for the quarter ended 31 March 2019, have been completed.

IOOF CEO, Renato Mota, said that IOOF have 'continued to work diligently to implement all items required under the licence conditions by the 30 June deadline. I am confident we are building an industry leading governance framework for the future, servicing the interests of our members and clients'.

Board renewal — new board appointment: The statement adds that IOOF is progressing its board renewal processes adding that Ms Michelle Somerville has been appointed as an Independent Non-Executive Director from 1 October 2019. In addition, Lindsay Smartt has been appointed to the Boards of IOOF Investment Management Limited and IOOF as a new Independent Non-Executive Director.

[Source: IOOF ASX announcement 20/08/2019]

Related News: Presenting the full year results for IOOF, CEO Renato Motta said that 'in one of the most challenging years for our company and for the industry, we have focused on the imperatives of stabilising the business, with a view to delivering better outcomes for our clients and our shareholders'. Among other things, Mr Motta flagged that IOOF had strengthened governance capability (with the appointment of 3 new directors and two new executives as well as a conducting a review of senior management) and is 'delivering for clients' (eg +17% net promoter score for advisers vs the industry average of -30%).

The results also flagged $235 million in 'one off remediation costs' to customers (which The AFR commented was an increase from $10m disclosed at the end of last year).

[Sources: IOOF Investor Presentation 26/08/2019; [registration required] The AFR 26/08/2019]

In Brief | APRA is reportedly planning to intervene to prevent some superannuation funds 'gaming' the system. The AFR reports that APRA plans to release a discussion paper about the apportionment of growth vs defensive assets later in the year, though notes it is 'too early' to say how the findings may be incorporated into reporting standards/prudential guidance

[Source: [registration required] The AFR 27/08/2019]

Risk Management

AUSTRAC has reportedly called for unregistered money transfer dealers, who the regulator considers to be at risk of exploitation by sophisticated criminal actors, to 'stop now'

The ABC reports that the Australian Transaction Reports & Analysis Centre (AUSTRAC) has launched community campaign to raise awareness of the risks and potential penalties for providing unregistered money transfer services.

Reportedly, AUSTRAC considers that unregistered dealers are at risk of being exploited by sophisticated criminal organisations. The ABC quotes Australian Transaction Reports & Analysis Centre CEO Nicole Rose as saying that small home-based transfer operators can be exposed to human trafficking, child exploitation, illegal firearms sales and drug networks. 'People might legitimately be asking them to send money back to their families but not knowing those companies are involved with criminal enterprises or money laundering' Ms Rose reportedly said.

Reportedly Ms Rose called for unregistered money transfer dealers to 'stop now' or put in place appropriate safeguards to protect against 'criminals who try to launder their dirty money'.

[Source: The ABC 27/08/2019]

OAIC's 2019-2020 Corporate Plan flags the development of a code of practice for digital platforms to provide stronger online protections as a key action

On 23 August, the Office of the Australian Commission (OAIC) released its Corporate Plan for 2019-2020.

The plan includes four strategic priorities: 1) advance online privacy protections for Australians; 2) influence and uphold privacy and information access rights frameworks; 3) encourage and support the proactive release of government-held information; and 4) contemporary approach to regulation.

Key activities for the year ahead include the following.

1. developing a code of practice for digital platforms to provide stronger online protections, including for vulnerable people such as children; and

2. embedding and enforcing strong privacy safeguards in Australia's new data portability regime (the Consumer Data Right)

[Note: Recommendation 18 of the ACCC's Digital Platforms Inquiry Final Report recommends that OAIC develop an enforceable code of practice for digital platforms. For a high level summary of the recommendations see: Governance News 31/07/2019. For expert insights into the implications of the proposed reforms see: ACCC calls for competition reforms that will impact digital platform operators and beyond]

In addition, the plan details OAIC's approach to helping agencies understand their freedom of information obligations and realise the benefits of proactively releasing information.

Commenting on the plan, Commissioner Angelene Falk said 'We are engaged and agile in responding to our changing environment, and our efforts are targeted to address emerging and priority issues and meet community expectations, putting the community at the centre of what we do. Above all, we are independent, operating fairly and impartially as the expert authority in guiding regulated entities, enforcing compliance and protecting Australians' privacy and information access rights'.

[Sources: OAIC media release 23/08/2019; OAIC Corporate Plan 2019-2020]

In Brief | Second New Payments Platform breach? Reportedly more than 90,000 Australian bank and credit union customers using the RBA's real-time New Payments Platform have had their bank details and other personal data exposed. Reportedly, PayID was breached via Credit Union Australia, in the second major attack on the payment management system in recent months

[Sources: [registration required] 25/08/2019; The SMH 26/08/2019; [registration required] The AFR 26/08/2019; 9News 26/08/2019]