Governance News

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Diversity

In Brief | (Gender) diversity pays? Macquarie University Business School has announced that their own research has found that companies with a female CEO or with three or more women on their board, tend to outperform other less (gender) diverse companies

[Source: Macquarie University media release 29/01/2020]

Remuneration

In Brief | An end to the no-profit, no bonus approach? The FT reports that Deutsche Bank executives will receive 50% of their bonuses (having voluntarily waived 50%) breaking, with the recent practice of waiving bonuses during unprofitable years. Reportedly, the lender is set to report an estimated €5bn loss

[Source: [registration required] The FT 30/01/2020]

Regulators

In Brief | APRA's supervisory and prudential priorities for the next 12 to 18 months released: Among APRA's key cross-industry policy priorities for 2020 are initiatives aimed at driving improvements in GCRA, including finalising a more robust prudential standard on remuneration, and updating prudential standards on governance and risk management. APRA's supervision priorities for 2020 include a closer assessment of institutions' capabilities to deal with cybersecurity and climate risks (among others)

[Note: A detailed summary of APRA's policy and supervisory priorities will be included in the next issue of Governance News which is due to be released on 12 February.]

[Sources: APRA media release 30/01/2020; APRA's Policy Priorities 2020; APRA's supervision Priorities 2020]

In Brief | ASIC's latest 'red tape' report — Report 654: Overview of decisions on relief applications (April 2019 to September 2019) — outlines decisions on relief applications and highlights ASIC's efforts to reduce red-tape and achieve a practical, positive outcome for companies seeking regulatory flexibility, without harming stakeholders

[Sources: ASIC media release 03/02/2020; ASIC Report 654: Overview of decisions on relief applications (April 2019 to September 2019)]

Disclosure and Reporting

United States | An 'elephant in the room' or sensible measures to streamline requirements? SEC has proposed amendments to 'modernise and enhance' financial disclosures (but one Commissioner has issued a statement questioning why the proposed changes make no mention of ESG)

On 30 January, The US Securities and Exchange Commission (SEC) announced proposed amendments to 'modernise, simplify, and enhance certain financial disclosure requirements in Regulation S-K'.

SEC says that the proposed changes are intended to: a) eliminate duplication in disclosures; b) modernise and enhance Management's Discussion and Analysis disclosures for the benefit of investors; and c) to streamline compliance requirements for companies.

Some Key Changes

Proposed changes include the following: a) eliminating Item 301 (selected financial data) and Item 302 (supplementary financial data); and b) amending Item 303 (management's discussion and analysis).

In addition, SEC has released guidance on key performance indicators and metrics in Management's Discussion and Analysis.

Announcing the proposed changes, SEC Chair Jay Clayton said that the proposed changes 'would improve the quality and accessibility of registrants' presentation of financial results and performance metrics…The improved disclosures would allow investors to make better capital allocation decisions, while reducing compliance burdens and costs without in any way adversely affecting investor protection.'

Next steps? The proposal will have a 60-day public comment period following its publication in the Federal Register. The guidance will be effective upon publication in the Federal Register.

Comments from SEC Commissioners?

Two SEC commissioners publicly commented on the proposal's omission of any mention of disclosures on environmental, social and governance issues.

'Ignoring the elephant in the room'?

In a statement, Commissioner Allison Herren Lee criticised the proposal, saying that it is 'most notable for what it does not do: make any attempt to address investors' need for standardized disclosure on climate change risk'.

To date, Ms Herren argues, the existing 'materiality' standard has not produced 'sufficient disclosure to ensure that investors are getting the information they need…Investors have been clear that this information is material to their decision-making process, and a growing body of research confirms that. And MD&A [management's discussion and analysis] is uniquely suited to disclosures related to climate risk; it provides a lens through which investors can assess the perspective of the stewards of their investment capital on this complex and critical issue'.

Ms Herren also raised concerns about other proposed changes. 'In addition to my overarching concern regarding climate risk disclosures, I note that today's proposal would eliminate significant disclosure items [Item 301(Selected Financial Data), Item 302 (Supplementary Financial Information), Item 303(a)(4) (MD&A, Off-balance sheet arrangements), and Item 303(a)(5) (MD&A, Tabular disclosure of contractual obligations)] while laudably enhancing others. And, as with our last Regulation S-K proposal, today's proposal heavily favors a principles-based approach rather than balancing the use of principles with line-item disclosure. I continue to be concerned that the increased flexibility and discretion that this approach affords company executives may result in significant costs to investors — both if materiality is misapplied and through the loss of important comparability in disclosure. I hope we will receive robust comment on these issues, as well as on climate risk disclosures' Ms Herren said.

The right approach? Separately, Commissioner Hester Peirce, said in a statement that the proposed changes are the right approach because they 'do not bow to demands for a new disclosure framework, but instead support the principles-based approach that has served us well for decades'.

'Securities regulators of this generation must not grow weak-kneed in defending the concept of materiality, which continues to play a central role in ensuring the vibrancy of our capital markets. We ought not step outside our lane and take on the role of environmental regulator or social engineer' Ms Peirce states.

[Sources: SEC Media release 30/01/2020; [registration required] The WSJ 31/01/2020]

Risk Management

Pressure to raise ESG standards: State Street to 'take appropriate voting action' against board members at large companies (including ASX 100 companies) considered to be lagging on ESG from this year

Key Takeouts

- State Street Global Advisors (SSGA) plans to 'take appropriate voting action' against board members at large US, UK, Australian, Japanese, German and French companies that it considers (based on their responsibility factor scores) to be laggards on ESG issues, starting this year.
- From 2022, SSGA will also start voting against the board members of all companies that have consistently underperformed their peers.

The President and CEO of State Street Global Advisors (SSGA) Cyrus Taraporevala, has written to SSGA board members outlining SSGA's plans for 'active engagement with boards on sustainability' over the coming year, and more particularly State Street's decision to use its 'proxy vote to press companies that are falling behind and failing to engage' on the issue.

Some Key Points

- **ESG score will soon be considered as important as a company's credit rating?** Last year, SSGA started measuring companies' ESG performance — ie assessing each company's business operations and governance operations as it relates to financially material and sector-specific ESG issues — using a scoring system called the R-Factor (the 'R' stands for Responsibility). The R-Factor is now used by SSGA both externally, to assist clients to understand their portfolio exposures, and internally to inform SSGA's stewardship engagements and investment decisions. Mr Taraporevala writes that SSGA considers that 'a company's ESG score will soon effectively be as important as its credit rating'.

- **SSGA to vote against board members (including in the ASX 100) whose companies score poorly on ESG:** Mr Taraporevala writes that 'beginning this proxy season, we will take appropriate voting action against board members at companies in the S&P 500, FTSE 350, ASX 100, TOPIX 100, DAX 30, and CAC 40 indices that are laggards based on their R-Factor scores and that cannot articulate how they plan to improve their score'. He adds that, 'beginning in 2022, we will expand our voting action to include those companies who have been consistently underperforming their peers on their R-Factor scores for multiple years, unless we see meaningful change. We believe doing so is in the best interests of investors and companies alike'.

- **Roadmap to incorporating sustainability into long-term strategy:** SSGA has made R-factor scores available to companies and has circulated a framework or 'roadmap' — ESG oversight framework for directors — to assist companies to incorporate sustainability into long-term strategy.

- **Fiduciary duty to 'maximise the probability of attractive long term returns':** Mr Taraporevala writes that SSGA is 'focused on financially material ESG issues' because it considers it owes a fiduciary responsibility to its clients to 'maximise the probability of attractive long-term returns'.

[Source: Harvard Law School Forum on Corporate Governance and Financial Regulation 03/02/2020; [registration required] The FT 29/01/2020; Financial Standard 30/01/2020]

Financial Services

Financial Services Royal Commission recommendations

Top Story | Details released: Consultation on a raft of Hayne legislation launched

The government released over 20 pieces of draft legislation for consultation proposing to implement 22 Hayne recommendations and other 'additional commitments'.

Summary of the proposed changes: We have prepared a table summarising the proposed changes, including proposed commencement dates. You can access it on the MinterEllison website here.

The table is also attached as an Appendix to this issue of Governance News.

Implementing FSRC recommendations 1.6, 2.7, 2.8, 2.9 and 7.2: consultation on a draft Bill proposing to introduce new referencing checking, information sharing, investigation and remediation obligations

Overview | [Exposure draft] Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020: FSRC rec 1.6, 2.7, 2.8, 2.9 and 7.2 (Reference checking and information sharing, breach reporting and remediation)

Key Takeouts

- Broadly, the draft Bill proposes to:
  - introduce new reference checking and information sharing obligations for AFSL holders and ACL holders
  - strengthen the breach reporting regime for financial services and credit licensees
  - introduce new requirements for investigating and remediating misconduct
  - introduce new penalty provisions for non-compliance
- The deadline for submissions on the draft legislation is 28 February 2020
- The proposed commencement date is 1 July 2020

Financial Services Royal Commission (FSRC) recommendations

The draft Bill — [Exposure draft] Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020: FSRC rec 1.6, 2.7, 2.8, 2.9 and 7.2 (Reference checking and information sharing, breach reporting and remediation) — proposes to implement the government's response to the following FSRC recommendations.

- **Recommendation 1.6 (misconduct by mortgage brokers):** Australian Credit Licence (ACL) holders should: a) be bound by information-sharing and reporting obligations in respect of mortgage brokers similar to those referred to in Recommendations 2.7 and 2.8 for financial advisers; and b) take the same steps in response to detecting misconduct of a mortgage broker as those referred to in Recommendation 2.9 for financial advisers.

- **Recommendation 2.7 (reference checking and information sharing):** All Australian Financial Services Licence (AFSL) holders should be required, as a condition of their licence, to give effect to reference checking and information-sharing protocols for financial advisers, to the same effect as now provided by the Australian Banking Association in its 'Financial Advice – Recruitment and Termination Reference Checking and Information Sharing Protocol'

- **Recommendation 2.8 (reporting compliance concerns):** All AFSL holders should be required, as a condition of their licence, to report 'serious compliance concerns' about individual financial advisers to ASIC on a quarterly basis.

- **Recommendation 2.9 (misconduct by financial advisers):** All AFSL holders should be required, as a condition of their licence, to take the following steps when they detect that a financial adviser has engaged in misconduct in respect of financial advice given to a retail client (whether by giving inappropriate advice or otherwise): a) make

whatever inquiries are reasonably necessary to determine the nature and full extent of the adviser's misconduct; and b) where there is sufficient information to suggest that an adviser has engaged in misconduct, tell affected clients and remediate those clients promptly.

Overview: Proposed changes

Proposed changes include the following.

- **Introduce new reference checking and information sharing obligations**

  - **Require AFSL and ACL licensees, as an obligation under their licences, to comply with a new reference checking and information sharing protocol** (to be made by ASIC). It's proposed that the new obligations would apply in relation to: a) a licensee who is an individual eg a current or former licensee who is seeking to work for another licensee; and b) a former, current or prospective representative of a licensee (eg a financial adviser who currently works for a licensee and is seeking employment with another licensee). The explanatory memorandum states that the measures requiring all licensees to comply with the new protocol is intended to 'ensure that there is consistent practice throughout the industry, and that employment information will be available about all financial advisers and mortgage brokers'.

  - **Enable ASIC to determine record keeping requirements** in the protocol in order to enable the regulator to monitor compliance with the information sharing and reference checking obligation

  - **Create a civil penalty for non-compliance with the obligation**. It's proposed that licensees will have a defence of qualified privilege against a defamation action or a breach of confidence action resulting from information shared as part of the obligation.

- **Strengthen the breach reporting regime for financial services and credit licensees** by:

  - **Expanding the situations that need to be reported to ASIC**. For example, financial services licensees will need to report significant breaches and likely breaches and investigations into whether there has been a significant breach. Licensees will also need to report reportable situations about other financial advisers to ASIC and the relevant licensee responsible for the financial adviser. The test for when a breach or likely breach is significant will include objectively determinable criteria. These criteria are in addition to the existing subjective significance test.

    Credit licensees will be subject to a breach reporting regime that is comparable to the new regime for financial services licensees

  - **Requiring licensees to report matters to ASIC within 30 calendar days** after the licensee reasonably knows the matter has arisen. Outcomes of investigations need to be reported within ten calendar days.

  - **Requiring reports to be lodged in the form prescribed/approved by ASIC**.

  - **Requiring ASIC to publish data on breaches**. The explanatory memorandum states that 'ASIC's publication must contain information about the licensees that have lodged reports about their own significant breaches and likely breaches of core obligations. This means the publication will contain licensee-level data'. More particularly, the explanatory memorandum says that 'it is expected' that the publication could include: a) the name of the licensee; b) the volume of reported breaches; c) give a breakdown of breach reports by corporate group; and d) the number of breaches compared to the size, activity or volume of business associated with an entity. It's proposed that ASIC will be required to publish this information on its website within four months after the end of each financial year, starting on the financial year ending on 30 June 2021.

  - **Introduce penalties for non-compliance with the reporting obligation**

Investigating and remediating misconduct

- **The Bill proposes to introduce new obligation on AFSL and ACL licensees** to investigate potential and actual misconduct engaged in by financial advisers and mortgage brokers, and to inform and remediate affected clients. The new obligation has two limbs:

    1. when a licensee detects misconduct, the licensee is required to: a) within 30 days, inform potentially affected clients of misconduct; and b) investigate the nature and full extent of any misconduct (including the loss or damage the affected client or consumer suffered or will suffer) within a reasonable amount of time; and

    2. once an investigation is complete, the licensee is required to: a) within 10 days, inform the affected client of the nature and full extent of the misconduct; and b) within 30 days, remediate the client's or consumer's loss.

- **Penalties for failure to notify, investigate and provide a remedy for identified misconduct:** It's proposed that AFSL and ACL licensees who fail to comply with the obligation to notify, investigate and remediate misconduct will be subject to civil penalties and criminal penalties.

- **Obligation to maintain records:** It's proposed that AFSL and ACL licensees be required to maintain records to demonstrate compliance with the requirement to notify, investigate and remediate misconduct.

Timing

- The deadline for submissions on the draft legislation is 28 February.

- The proposed implementation date for the (proposed) reforms is 1 July 2020.

[Sources: [Exposure draft] Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020: FSRC rec 1.6, 2.7, 2.8, 2.9 and 7.2 (Reference checking and information sharing, breach reporting and remediation); Draft explanatory memorandum]

Implementing FSRC recommendation 4.6: Consultation on legislation proposing to limit the circumstances in which an insurer may avoid life insurance contracts

Overview | [Exposure draft Bill] Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020: Avoidance of life insurance contracts (FSRC Rec 4.6)

Financial Services Royal Commission Recommendation 4.6 recommended that section 29(3) of the Insurance Contracts Act 1984 (Cth) (ICA) should be amended so that 'an insurer may only avoid a contract of life insurance on the basis of non-disclosure or misrepresentation if it can show that it would not have entered into a contract on any terms.'

On 31 January the government released exposure draft legislation — Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020: Avoidance of life insurance contracts (FSRC Rec 4.6) — proposing to implement the government's response to this recommendation.

Some Key Points

Schedule 1 of the draft Bill proposes to amend the Insurance Contracts Act 1984 (ICA) to limit the circumstances in which an insurer can avoid a contract of life insurance because of a non-fraudulent misrepresentation or non-fraudulent failure to comply with the duty of disclosure by the insured to the insurer.

More particularly, the draft Bill proposes repeal the existing broad discretion for an insurer to avoid a contract of life insurance under subsection 29(3) of the ICA and replace it with a new subsection 29(3).

The new subsection would provide that an insurer is able to avoid a contract of life insurance on the basis of a misrepresentation or failure by the insured to comply with their duty of disclosure (within three years of entering into the contract of life insurance) if the failure to comply with the duty of disclosure was not

fraudulent or the misrepresentation was not made fraudulently; and subject to the insurer demonstrating that, if the duty of disclosure had been complied with or the misrepresentation not been made, it would not have been prepared to enter into a contract of life insurance with the insured on any terms.

Timing

- **Submissions:** The due date for submissions on the draft legislation is 28 February.
- **Proposed implementation date?** It's proposed that the measures in the draft Bill will apply to life insurance contracts originally entered into after the commencement of the legislation (once finalised). The proposed commencement date for the measures is the day after the legislation receives Royal Assent.

  Additionally, it's proposed that if a contract entered into prior to the commencement of the Bill is varied after that commencement date to increase the sum insured or to provide one or more additional kinds of insurance cover, then, to the extent of that variation, the contract is treated as though it were entered into after the commencement date.

[Sources: Exposure draft Bill: Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020: Avoidance of life insurance contracts (FSRC Rec 4.6); Draft explanatory memorandum]

Implementing FSRC recommendation 4.4: Consultation on draft legislation proposing to cap commissions paid to vehicle dealers

Overview | [Exposure draft Bill] Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020: Caps on Commissions

Financial Services Royal Commission Recommendation 4.4 recommended that the Australian Securities and Investments Commission (ASIC) should impose a cap on the amount of commission that may be paid to vehicle dealers in relation to the sale of add-on insurance products.

On 31 January the government released exposure draft legislation — Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020: Caps on Commissions —
— proposing to implement the government's response to this recommendation.

The draft Bill proposes to amend the Australian Securities and Investments Commission Act 2001 (ASIC Act) to place a cap on the amount of commissions that may be paid in relation to add-on risk products such as tyre and rim insurance, mechanical breakdown insurance and consumer credit insurance (for the credit facility) supplied in connection with the sale or long-term lease of a motor vehicle.

More particularly, the draft Bill proposes to amend the ASIC Act to:

- give ASIC the power, by legislative instrument, to set caps on the amount of commissions that may be paid in relation to certain add-on risk products sold in connection with the sale or long-term lease of a motor vehicle;
- make it a criminal offence, civil penalty and offence of strict liability for a person to pay or receive a commission in relation to an add-on risk product that exceeds the cap determined by ASIC for that product; and
- where commissions are paid in excess of the cap, give consumers the right to recover the entire amount of the commission.

Timing

- **The deadline for submissions** on the draft legislation is 28 February.

- **Proposed implementation date?** It's proposed that the (proposed) changes will apply to commissions provided under contracts/arrangements/understanding entered into on/or after the legislation receives Royal Assent.

[Sources: Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020: Caps on Commissions; draft explanatory memorandum]

Implementing FSRC recommendation 6.14: Consultation on draft legislation proposing to establish an independent assessment authority (Financial Regulator Assessment Authority) to review the effectiveness of APRA and ASIC

Overview |

- **[Exposure draft] Financial Regulator Assessment Authority Bill 2020**
- **[Exposure draft] Financial Sector Reform (Hayne Royal Commission Response—Stronger Regulators (2020 Measures)) Bill 2020: FSRC rec 6.14 (Financial Regulator Assessment Authority)**

Financial Services Royal Commission Recommendation 6.14 recommended that a new oversight authority, independent of government, should be established by legislation to assess the effectiveness of the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) in discharging their functions and meeting their statutory objects.

On 31 January the government released two draft Bills — Financial Regulator Assessment Authority Bill 2020 (Assessment Authority Bill) and Financial Sector Reform (Hayne Royal Commission Response—Stronger Regulators (2020 Measures)) Bill 2020: FSRC rec 6.14 (Financial Regulator Assessment Authority) (Stronger Regulators Bill) — for consultation, proposing to implement the government's response to this recommendation.

Proposed changes

Proposed changes include the following.

Draft Assessment Authority Bill

- **Establish the new oversight body, the Financial Regulator Assessment Authority** (Authority) and provide for its functions and powers. It's proposed that the new Authority will have four members: three independent members appointed by the Minister (including the Chair and two other members); and a departmental member (who will be the Secretary of the Department or a nominated SES employee).
- **Specify the functions and powers of the Financial Regulator Assessment Authority:** It's proposed that the Authority's key functions will be to: a) biennially assess and report to the Minister on APRA' and ASIC's effectiveness; b) when requested by the Minister, undertake or cause someone else to undertake capability reviews of each of APRA and ASIC and report to the Minister; c) on an ad hoc basis, either on its own initiative or when requested by the Minister, report to the Minister on any matter relating to either or both of APRA's effectiveness and ASIC's effectiveness.
- **Limits:** The explanatory memorandum states that as ASIC and APRA are independent entities responsible to the Parliament, they are not accountable to the Authority and accordingly, that the Authority will not have the power to direct the regulators to implement any recommendations it makes.

  In addition, it's proposed that the Authority's functions will not include assessing or reporting on only a single case eg the Authority will not be permitted to assess and prepare a report about the effectiveness of one particular regulatory action or enforcement matter undertaken by APRA or ASIC.

Further, the explanatory memorandum states that 'the Department remains responsible for advising the Minister on the regulators' funding and efficiency, as well as their role in the financial system more broadly. It is not the role of the Authority to report on these matters, or on broader financial system policy'.

- **Information management:** The draft Bill proposes to introduce a number of safeguards on information provided to the authority by ASIC and APRA and necessary to the performance of its oversight role, which is not 'suitable for publication or further disclosure' ('protected information'). These include:
  - prohibiting the Authority from including any protected information in a report or review and requiring the Authority to consult with APRA and ASIC (as relevant) to ensure that such information is not included
  - making the unauthorised use or disclosure of protected information by an entrusted person (ie a person who may receive protected information int eh course of their duties), a criminal offence punishable by up to two years' imprisonment

Stronger Regulators Bill: The Stronger Regulators Bill proposes to make amendments consequential to the enactment of the Assessment Authority Bill.

Timing

- The due date for submissions on the draft legislation is 28 February
- The proposed commencement date for the Assessment Authority Bill (once finalised) is 1 July 2020. However, it's proposed that the assessment reporting and capability review timeframes will not commence until 2021, to allow time for members and staff of the Authority to be appointed, and for the Authority to meet and determine its method of operations.
- It's proposed that the consequential amendments to other Commonwealth Acts included in the Stronger Regulations Bill will commence at the same time as the Assessment Authority Bill (ie 1 July 2020).

[Sources: exposure draft Bill: Financial Regulator Assessment Authority Bill 2020; exposure draft Bill: Financial Sector Reform (Hayne Royal Commission Response—Stronger Regulators (2020 Measures)) Bill 2020: FSRC rec 6.14 (Financial Regulator Assessment Authority); Draft explanatory memorandum]

Implementing FSRC recommendation 1.15: Consultation on draft legislation proposing to enable ASIC to designate enforceable code provisions in approving financial sector industry codes and to introduce a new framework for establishing mandatory codes of conduct for the financial services industry through regulations

Overview| [Exposure draft] Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020 FSRC Rec 1.15 (Enforceable Code Provisions)

These draft Bill proposes to implement the government's response to recommendation 1.15 of the Financial Services Royal Commission.

Recommendation 1.15 recommended that the law should be amended to provide:

- that ASIC's power to approve codes of conduct extends to codes relating to all APRA-regulated institutions and ACL holders;
- that industry codes of conduct approved by ASIC may include 'enforceable code provisions', which are provisions in respect of which a contravention will constitute a breach of the law;
- that ASIC may take into consideration whether particular provisions of an industry code of conduct have been designated as 'enforceable code provisions' in determining whether to approve a code;

- for remedies, modelled on those now set out in Part VI of the Competition and Consumer Act 2010 (Cth), for breach of an 'enforceable code provision'; and
- for the establishment and imposition of mandatory financial services industry codes.

Proposed changes

Proposed changes include the following.

- The draft Bill proposes to 'build on' the existing codes framework contained in the Corporations Act 2001 (Cth) (Corporations Act) and the National Consumer Credit Protection Act 2009 (Credit Act) to allow ASIC to designate enforceable code provisions in approving financial sector industry codes. If ASIC identifies one or more provisions of a code to be an enforceable code provision, it becomes enforceable under statute.
- The framework will allow ASIC to approve codes of conduct via legislative instrument which may contain enforceable code provisions.
- A breach of an enforceable code provision may attract civil penalties (including pecuniary penalties) and/or other administrative enforcement action from ASIC.
- New independent review requirement: The applicant in relation to a code of conduct must ensure that an independent review of the code is undertaken every five years.
- Mandatory codes can be prescribed in regulations: The Bill also proposes to introduce a framework for establishing mandatory codes of conduct for the financial services industry through regulations. Certain provisions within the mandatory code of conduct may be determined as civil penalty provisions. A breach of these provisions may attract civil penalties (including pecuniary penalties) and/or other administrative enforcement action from ASIC.

Timing

- The due date for submissions on the draft legislation is 28 February.
- The proposed implementation date is 1 July 2020.

[Sources: Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020 FSRC Rec 1.15 (Enforceable Code Provisions); Draft explanatory memorandum]

Implementing FSRC recommendation 2.1: Consultation on draft legislation targeting the issue of fee for no service conduct in the context of financial advice

Overview |

- **[Exposure draft] Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020: FSRC rec 2.1 (ongoing free arrangements)**
- **[Exposure draft] Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers) (ongoing Fee Arrangements) Regulations 2020: FSRC rec 2.1**

Financial Services Royal Commission recommendation 2.1 recommends that the law should be amended to provide that ongoing fee arrangements (whenever made): a) must be renewed annually by the client; b) must record in writing each year the services that the client will be entitled to receive and the total of the fees that are to be charged; and c) may neither permit nor require payment of fees from any account held for or on behalf of the client except on the client's express written authority to the entity that conducts that account given at, or immediately after, the latest renewal of the ongoing fee arrangement.

The draft Bill proposes to implement the government's response to this recommendation.

Proposed changes

The Draft Bill proposes to amend the Corporations Act 2001 (Cth) (Corporations Act) to require financial services providers that receive fees to:

- seek annual renewal from clients for all ongoing fee arrangements (ie new and existing ongoing fee arrangements will need to be renewed annually)
- require fee recipients to disclose in writing the total fees that will be charged
- set out the services that will be provided during the following 12 month period
- obtain written consent before fees under an ongoing fee arrangement can be deducted from a client's account.

In addition, the government has released draft regulations that outline the record keeping compliance requirements for fee recipients to support the operation of the draft Bill.

The explanatory memorandum says that the proposed reforms are designed to address fee for no service conduct.

Timing: The due date for submissions on the draft legislation is 28 February 2020. The proposed commencement date for both the Draft Bill and the Draft Regulations is 1 July 2020.

[Sources: Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020; Draft explanatory memorandum; Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers) (Ongoing Fee Arrangements) Regulations 2020; Draft explanatory statement]

Industry response?

The AFR reports that Financial services industry bodies were reportedly 'quick to welcome the legislation' though the AFR says that they also cautioned that the proposed annual renewal requirement would impose a 'red rape burden' on advisers, the cost of which could push up costs for consumers.

The AFR quotes Financial Planning Association CEO Dante De Gori as saying that he considers that requiring fee renewals 'to be conducted annually without any modification to the laws around when an ongoing fee arrangement can be renewed rather than reset, adds considerable time and cost pressures on financial planning practices. It is not practical and will be too much of an administrative burden for many.'

Mr De Gori reportedly added, 'Financial advice must be affordable for all Australians, not just the wealthy…Reforms need to consider the cost of compliance, as this will ultimately be passed on to consumers.'

Reportedly, Financial Services Council CEO Sally Loane also flagged that the requirement could impact affordability.

[Source: [registration required] The AFR 02/03/2020]

Implementing FSRC recommendation 2.2: Consultation on draft legislation proposing to impose a new requirement on financial advisers to disclose their lack of independence

Overview| [Exposure draft] Financial Sector Reform (Hayne Royal Commission response — Protecting Consumers (2020 Measures)) Bill 2020: FSRC Rec 2.2 (disclosure of lack of independence)

Financial Services Royal Commission Recommendation 2.2 recommended that the law be amended to require that a financial adviser who would contravene section 923A of the Corporations Act 2001 (Cth) (Corporations Act) by assuming or using any of the restricted words or expressions identified in section 923A(5) (including 'independent', 'impartial' and 'unbiased') must, before providing personal advice to a retail client, give to the client a written statement (in or to the effect of a form to be prescribed) explaining simply and concisely why the adviser is not independent, impartial and unbiased.

The draft Bill proposes to implement the government's response to this recommendation.

Proposed changes: New requirement to disclose lack of independence

The Draft Bill proposes to amend the Corporations Act to require a providing entity (ie a financial services licensee or authorised representative) to give a written disclosure of lack of independence in the form prescribed by the Australian Securities and Investments Commission (ASIC) where they are authorised to provide personal advice to a retail client.

This means that a providing entity who provides personal advice to a retail client and who would contravene subsection 923A(1) by assuming or using a restricted word or expression (within the meaning of subsection 923A(5)) will be required to include a statement in the Financial Services Guide that explains that they are not independent, impartial or unbiased and the reasons why.

The explanatory memorandum says that this new requirement is aimed at improving the disclosure of conflicts of interest.

Timing

- **The due date for submissions** on the draft legislation is 28 February 2020
- **Proposed implementation date:** It's proposed that the amendments requiring providing entities to provide a lack of independence disclosure statement will apply in relation to personal advice provided on or after 1 July 2020. That is, it's proposed that Financial Services Guides provided to new clients on or after 1 July 2020 will need to include the lack of independence disclosure statement.

[Sources: Exposure draft: Financial Sector Reform (Hayne Royal Commission response — Protecting Consumers (2020 Measures)) Bill 2020: FSRC Rec 2.2 (disclosure of lack of independence); draft explanatory memorandum]

Implementing FSRC recommendation 3.1: Consultation on draft legislation proposing to prohibit superannuation trustees from having duties other than those arising from or in the course of the performance of their duties as a trustee of a superannuation fund

Overview | [Exposure Draft] Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020: RSE licence condition — no other duty (FSRC rec 3.1)

Financial Services Royal Commission Recommendation 3.1 recommended that the trustee of a superannuation fund should be prohibited from having any obligations other than those arising from or in the course of its performance of its duties as trustee of a superannuation fund.

The draft Bill proposes to implement the government's response to this recommendation.

No other duty: The draft Bill proposes to impose an additional condition on RSE licences held by a body corporate trustee. The condition would prohibit the RSE licensee from having a duty to act in the interests of another person, except in the course of: a) performing the RSE licensee's duties and exercising the RSE licensee's powers as a trustee of a registrable superannuation fund; or b) providing personal advice.

The draft explanatory materials clarify that 'the new licence condition only applies in respect of the duties that the licensee has. It does not matter if another entity in the same corporate group has a duty that would be in conflict with the new licence condition'.

Application: The new licence condition would only apply to an RSE licensee that is a body corporate (including an RSE licensee that is a constitutional corporation). It does not apply to individual trustees, groups of individual trustees or individual directors of body corporate trustees.

The explanatory materials state that this 'approach is reasonable given the various types of duties to act in the interests of another person an individual may be subject to, for example as trustee of a family trust or as part of their professional employment'.

Aim of the changes? The changes implement the government's response to Financial Services Royal Commission recommendation. The draft explanatory materials state that the new condition is intended to 'improve outcomes for beneficiaries of registrable superannuation funds by minimising the risk of unmanageable conflicts of duties arising from competing duties owed by a trustee of a registrable superannuation fund to beneficiaries of the fund and to other persons'.

Timing

- **The due date for submissions** on the proposed changes is 28 February 2020.
- **Proposed implementation date?** The proposed implementation date is 1 July 2020 ie it's proposed that the amendments will apply in relation to any duty that is had before, on or after 1 July 2020. The draft explanatory memorandum states that this will mean that 'registrable superannuation entities will therefore need to consider whether their existing structures are compliant with the new licence condition and may need to restructure by 1 July 2020 in order to comply with the new licence condition'.

  The draft explanatory memorandum says that government is considering providing some relief to an RSE licensee that needs to transfer the responsible entity function to another entity within the same corporate group for the purposes of complying with the new licence condition and welcomes comments whether the relief is required, and if so, what the scope of that relief should be.

[Sources: Exposure draft: Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020: RSE licence condition—no other duty (FSRC rec 3.1); Draft explanatory memorandum]

Implementing FSRC recommendations 3.2 and 3.3: Consultation on draft legislation proposing changes to advice fees for MySuper and Choice products

Overview | [Exposure draft Bill] Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020: fees (FSRC Rec 3.2 and 3.3)

Key Takeout: The draft Bill proposes to remove a superannuation trustee's capacity to charge advice fees from MySuper products and remove the capacity of a superannuation trustee to charge advice fees to a member (other than fees for intra-fund advice) unless certain conditions are satisfied.

Recommendations 3.2 and 3.3 of the Financial Services Royal Commission, recommended banning the deduction of advice fees from MySuper products and imposing limitations on the deduction of advice fees from choice products.

The draft Bill proposes to implement the government's response to these recommendations.

Proposed changes

The draft Bill proposes to:

- amend Part 11A of the Superannuation Industry (Supervision) Act 1993 (Cth) (SIS Act) to ensure that a superannuation trustee can only charge advice fees (other than fees for intra-fund advice) to a member where certain conditions are satisfied. These conditions are: a) that the fee is in accordance with an arrangement that the member has entered into; b) the member has consented in writing to being charged the fee; and c) the trustee has the written consent or a copy of it.

- amend Part 2C of the SIS Act to remove a trustee's ability to charge advice fees in relation to MySuper products. Trustees would still be permitted to charge fees in relation to intra-fund advice as administration fees (which must be collectively charged in accordance with the applicable charging rules in section 29VA).

The explanatory memorandum says that the proposed changes are aimed at providing 'greater protection for superannuation members' against paying for inappropriate financial advice and fees for no service'.

In addition, the amendments are aimed at 'increasing the visibility of advice fees in superannuation, and better allowing members to make an assessment about the value of the advice they are receiving'.

Timing

- **The deadline for submissions** on the draft legislation is 28 February 2020

- **Proposed implementation date:** It's proposed that the changes will apply:

    - to any fees payable under an arrangement entered into on or after 1 July 2020

    - to any fees in respect of ongoing fee arrangements (OFAs) that were previously grandfathered under the Future of Financial Advice reforms from 1 January 2021

    - to any other existing arrangements that were entered into before 1 July 2020 from 1 July 2021

[Sources: Exposure draft Bill: Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020: fees (FSRC Rec 3.2 and 3.3); draft explanatory memorandum]

Implementing FSRC recommendations 3.4 and 4.1: Consultation on draft legislation proposing to introduce one general prohibition for the hawking of all financial products

Overview |

- **[Exposure draft] Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020: Hawking of Financial Products**

- **[Exposure draft] Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Regulations 2020: Hawking of financial products**

The draft Bill proposes to implement the government's response to two Financial Services Royal Commission recommendations:

- Recommendation 3.4 recommended the hawking of superannuation products be banned.

- Recommendation 4.1 recommended that the hawking of insurance products be banned.

Proposed changes: Draft Bill

- **General hawking prohibition:** The draft Bill proposes to amend section 992A of the Corporations Act 2001 (Cth) (Corporations Act) to 'strengthen the existing hawking prohibition' by introducing one general prohibition for the hawking of **all** financial products.

- **Under the new prohibition, an offer, request or invitation is only prohibited if it is made in the course of, or because of, unsolicited contact.** Under the new prohibition on hawking, a person would be prohibited from offering a financial product for issue, transfer or sale to another person; or requesting or inviting another person to ask, apply or purchase a financial product if the offer, request or invitation is made in the course of, or because of, unsolicited contact with the other person.

- **What is 'unsolicited contact'?** Contact is 'unsolicited contact' if it is not requested by a consumer and the contact is, wholly or partly, made by telephone, in a face-to-face meeting or any other form of contact which a reasonable person would consider creates the expectation of an immediate response eg cold calling.

  The draft explanatory memorandum states that 'standard email communication' and 'ordinary corporate transactions such as sending investors offer documents' are not 'expected' to fall into the category of 'unsolicited contact'. In addition, a 'positive request' for contact by a consumer about a financial product will not be 'unsolicited'.

- **The new prohibition will only apply to offers which are made to retail clients (it would not apply wholesale clients, or non-financial products).**

  - The hawking prohibition will apply to agents and representatives of product issuers, meaning that product issuers cannot circumvent the hawking prohibition by engaging a third party to make offers on their behalf.

  - In the superannuation context, the hawking prohibition would not apply to investment and insurance options for members that form part of a superannuation interest as such options are not financial products which can be offered to members separate to the superannuation interest itself.

- **Exceptions:** The hawking prohibition will not apply where 'another regime already gives appropriate consumer protection in relation to the offer of that financial product or where the consumer is expected to have enough knowledge to adequately assess the financial product offered'.

  The draft explanatory memorandum lists a number of examples of situations in which the hawking prohibition would not apply, including that: the prohibition will not apply to advice given to a client by a financial advisor who is required to act in the client's best interests under Division 2 of Part 7.7A of the Corporations Act in relation to that advice, or to offers made under eligible employee share schemes. Offers of listed securities and listed interests in managed investment schemes (MISs) which are made by financial services licensees over the phone, will also not be impacted by the hawking prohibition.

- **The new hawking prohibition does not prevent product issuers from advertising financial products:** Most advertisements would not constitute an offer and as a result would not be captured by the new law. In circumstances where the advertisement does amount to an offer or invitation, then it is unlikely to be hawking because advertisements do not usually create an expectation of immediate response from the consumer.

- **Penalty framework:** Consistent with the current penalty framework that applies to the hawking of financial products, a person who breaches the new hawking prohibition will be guilty of an offence and will be liable for six months imprisonment or 60 penalty units. This reflects the penalties which apply to a breach of the general hawking prohibition in the existing law.

Draft regulations

The draft regulations propose to amend the Corporations Regulations 2001 to remove exceptions to the hawking prohibition which curtail or reduce the effectiveness of the prohibition and ensure that the Corporations Regulations 2001 continue to operate effectively. In particular, the draft regulations: a) remove the explicit prohibition of hawking at particular times and on particular days because the amended prohibition against hawking in the draft Bill applies at all times; b) repeal modifications to sections of the Act that are repealed in the draft Bill; c) update some regulations to refer to new provisions in the draft Bill to preserve their operation; and d) repeal the exemption from the prohibition of hawking for litigation funding schemes and arrangements which is now in the draft Bill.

The draft regulations also preserve the operation of regulations relating to the right of return and refund for hawked financial products that were made under the repealed sections of Act but whose effect is retained in draft Bill.

Timing

- **The deadline for submissions** on the draft legislation is 28 February 2020.
- **Proposed implementation date:** The proposed commencement date for the measures in the draft Bill and the draft regulations is the same, 1 July 2020.

[Sources: Exposure draft: Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020: Hawking of Financial Products; draft explanatory memorandum; Exposure Draft Regulations; exposure draft explanatory statement]

Implementing FSRC recommendations 3.8, 6.3. 6.4 and 6.5: Adjusting the roles of the financial regulators

Overview |

- **[Exposure draft Bill] Financial Sector Reform (Hayne Royal Commission Response—Stronger Regulators (2020 Measures)) Bill 2020: ASIC regulation of superannuation (FSRC Rec 3.8, 6.3, 6.4, 6.5)**
- **[Exposure draft Regulations] Financial Sector Reform (Hayne Royal Commission Response—Stronger Regulators) (Regulation of Superannuation) Regulations 2020**

Financial Services Royal Commission recommendations

The draft legislation proposes to implement the government's response to the following Financial Services Royal Commission recommendations.

- Recommendation 3.8 recommended that the roles of the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) with respect to superannuation should be adjusted, as referred to in Recommendation 6.3.
- Recommendation 6.3 recommended that the roles of APRA and ASIC in relation to superannuation should be adjusted to accord with the general principles that: a) APRA, as the prudential regulator for superannuation, is responsible for establishing and enforcing Prudential Standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by superannuation entities APRA supervises are met within a stable, efficient and competitive financial system; and b) as the

conduct and disclosure regulator, ASIC's role in superannuation primarily concerns the relationship between RSE licensees and individual consumers.

- Recommendation 6.4 recommended that without limiting any powers APRA currently has under the SIS Act, ASIC should be given the power to enforce all provisions in the Superannuation Industry (Supervision) Act 1993 (Cth) (SIS Act) that are, or will become, civil penalty provisions or otherwise give rise to a cause of action against an RSE licensee or director for conduct that may harm a consumer. There should be co-regulation by APRA and ASIC of these provisions.

- Recommendation 6.5 recommended that APRA should retain its current functions, including responsibility for the licensing and supervision of RSE licensees and the powers and functions that come with it, including any power to issue directions that APRA presently has or is to be given.

Proposed changes

Proposed changes include the following.

- **Adjustments relating to the roles and responsibilities of superannuation industry regulators:** The draft Bill proposes to repeal section 4 of the SIS Act and replace it with a 'simplified outline' setting out high level statements outlining APRA, ASIC and the Commissioner of Taxation's supervision responsibilities. The draft explanatory memorandum states that the regulators' 'regulatory activities are complementary and overlapping, rather than mutually exclusive'.

    - **ASIC's role:** The draft Bill proposes to expand ASIC's role in superannuation to include protecting consumers from harm and market misconduct. ASIC would be 'generally responsible for consumer protection, market integrity, disclosure and the keeping of reports'. Additionally, ASIC would be responsible for administration of section 99FA, a new fee charging provision introduced through Financial Services Royal Commission recommendation 3.3.

    - **Co-regulation of provisions by ASIC and APRA:** It's proposed that APRA and ASIC will share general administration of SIS Act provisions which are civil penalty provisions or provisions that are otherwise enforceable, and have consumer protection and member outcomes 'as their touchstone'. The draft explanatory memorandum states that 'while co-regulation introduces overlap between APRA's member outcomes role and ASIC's consumer protection and market integrity role, in practice, APRA and ASIC have a natural focus on different aspects of conduct. ASIC's focus is generally on the relationship between superannuation trustees and individual consumers whereas APRA's focus is generally on the outcomes that trustees deliver for their membership as a whole, or cohorts of members'. Part 2 of the draft legislation introduces requirements for ASIC to obtain APRA's agreement before taking certain actions affecting RSE licensees eg the cancellation of an AFSL, the imposition of certain licence conditions and the making of certain banning orders.

    - **APRA's role:** The draft explanatory memorandum states that 'consistent with Financial Services Royal Commission recommendations 6.4 and 6.5, APRA's responsibilities in the SIS Act are largely unchanged'. The only substantive change to APRA's general administration is reflected in item 26 of the general administration table, which reallocates APRA's responsibility for section 68B of the SIS Act to ASIC.

    - **The Commissioner of Taxation's role is unchanged.**

Extension of the AFSL regime to cover a broader range of activities undertaken by APRA-regulated superannuation trustees: New financial service – providing a superannuation trustee service

- **The Bill creates a new type of financial service: providing a superannuation trustee service.** According to the draft explanatory memorandum, the purpose of creating the new financial service is to ensure that the conduct of RSE licensees in operating an RSE is subject to the Australian Financial Services License (AFSL) regime's obligations and protections. In addition, it's also proposed that the ASIC Act consumer protections will also apply to the provision of a superannuation trustee service.

- **What is a 'superannuation trustee service'?** The new financial service is intended to cover all of the activities involved in operating an RSE, at all stages of the trustee's interactions and transactions with members and others. Broadly, this is intended to ensure the AFSL and SIS Act regulatory regimes have comparable coverage of RSE licensee activities, and that all relevant activities of licensees need to be conducted in accordance with the conduct obligations in the AFSL regime.

  The draft explanatory memorandum states that 'the extension to the AFSL regime made by this Bill is intended to ensure that the regime's conduct obligations clearly apply to those superannuation trustee activities that may fall outside the parameters of dealing in a superannuation interest. In turn, this is intended to ensure ASIC is an effective conduct regulator in superannuation and can take action against misconduct by superannuation trustees, whatever the type of activity in question'.

- **Insurance claims handling is a superannuation trustee service:** Though RSE licensees will not need to obtain a specific AFSL authorisation to handle insurance claims, all of the AFSL obligations will still apply to their claims handling conduct as part of their provision of a superannuation trustee service. The draft explanatory memorandum includes a number of examples of activities 'intended to constitute the provision of a superannuation trustee service and attract all of the AFSL obligations'. These include: a) making a recommendation or stating an opinion that could influence a decision whether to make an insurance claim; b) assisting another person to make an insurance claim; c) assessing whether an insurer is liable under an insurance product, or providing assistance in relation to such an assessment; d) making a decision to accept or reject all or part of an insurance claim; e) quantifying an insurer's liability under an insurance product; f) offering to settle all or part of an insurance claim; and g) satisfying a liability of an insurer under an insurance claim.

- **Extending the SIS Act indemnification prohibitions:** 'In view of the extension of the AFSL regime to cover the provision of a superannuation trustee service' the Bill proposes to extend the existing indemnification provisions in the SIS Act to prevent trustees and directors from using trust assets to pay a criminal, civil or administrative penalty incurred through contravention of a provision of the Corporations Act or ASIC Act.

- **Alignment of breach reporting timeframes:** The Bill proposes to extend the timeframe within which an RSE licensee must report breaches of its RSE licence conditions from 10 business days to 30 calendar days. The draft explanatory memorandum explains that the change aligns the timeframe with the new 30 day breach reporting deadline for AFSL holders (Financial Services Royal Commission recommendation 2.8), thereby reducing the 'reporting burden' on dual regulated superannuation trustees.

[Note: The new requirement referred to above is a reference to the requirement in [Exposure draft] Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020. A short summary of the proposed changes in the draft legislation is included in a separate post in this issue of Governance News.]

- **Court to consider the impact of penalties on beneficiaries:** The Bill proposes to introduce a new requirement for courts, when considering the imposition of a fine for an offence committed by a trustee of an RSE, or a pecuniary penalty for a contravention of a civil penalty provision, to take into account the impact the fine or penalty would have on the beneficiaries of the RSE.

Draft regulations

The draft regulations propose to remove certain exemptions from the requirement to hold an AFSL to provide financial services, and to make other minor amendments in support of the broader reforms to the roles and responsibilities of the superannuation industry regulators as set out in the draft Bill.

Timing

- **The deadline for submissions** on the draft legislation is 28 February 2020
- **Proposed implementation dates for the measures in the draft Bill:**
  - It's proposed that RSE licensees will be required to comply with the general AFSL obligations in relation to the provision of a superannuation trustee services from 1 July 2020. However, the Bill contains a number of transitional provisions concerning the extension of the AFSL regime's coverage for superannuation trustee services.
  - It's proposed that the amendments to align the SIS Act timeframe for breach reporting with the Corporations Act timeframe for breach reporting will apply in relation to breaches of which an RSE licensee becomes aware on or after 1 April 2020.
  - It's proposed that the amendments of the SIS Act indemnification prohibition provisions will apply in relation to liabilities that arise, and amounts that become payable, before, on or after the commencement of the amendments on 1 July 2020
- **Draft regulations?** It's proposed that the regulations (once finalised) will commence on the later of the day after registration and 1 July 2020.

[Sources: Exposure draft Bill: Financial Sector Reform (Hayne Royal Commission Response—Stronger Regulators (2020 Measures)) Bill 2020: ASIC regulation of superannuation (FSRC Rec 3.8, 6.3, 6.4, 6.5); Draft explanatory memorandum; Exposure draft regulations; Draft explanatory statement]

Implementing FSRC 'additional commitment' in response to recommendation 4.2: Consultation on draft legislation proposing to restrict the use of the term 'insurance' and 'insurer'

Overview | [Exposure draft Bill] Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020: Use of terms 'insurance' and 'insurer'

Context: Implementing the 'additional commitment' in response to recommendation 4.2

Financial Services Royal Commission recommendation 4.2 recommended that the law should be amended to: a) remove the exclusion of funeral expenses policies from the definition of 'financial product'; and b) put beyond doubt that the consumer protection provisions of the ASIC Act apply to funeral expenses policies.

The government's response to the Commission's recommendations (released on 4 February 2019) included an 'additional commitment' in response to recommendation 4.2, namely to restrict the ability of firms to use terms such as 'insurer' and 'insurance' to only those firms that have a 'legitimate interest' in doing so.

In August 2019, the government released an implementation roadmap setting out its proposed timeframes for implementing its response to the Commission's recommendations, including a number of 'additional commitments'. The roadmap listed restricting use of the term 'insurer' and 'insurance' as an additional commitment in response to recommendation 4.2, to be consulted on and introduced by 30 June 2020.

Proposed changes: Some Key Points

- The draft Bill proposes to amend the Insurance Act 1973 (Cth) to restrict the ability of firms to use the terms 'insurer' and 'insurance' to only those firms that have a legitimate interest in using terminology regarding insurance.

- The draft Bill proposes to make it a strict liability offence for a business to:

    - describe a product or service that they offer as insurance, if the product or service is not insurance, in circumstances where it is likely that the product or service could mistakenly be believed to be insurance.

    - describe itself as an insurer if the business could mistakenly be believed to offer insurance, and either the product is not insurance or the person is not appropriately registered or authorised under either the: Insurance Act 1973; Life Insurance Act 1995; or Private Health Insurance (Prudential Supervision) Act 2015.

- The new offences do not apply to government entities, state insurance, products or services prescribed by the regulations, or entities exempted by ASIC.

- The penalty for the offence is 50 penalty units in the case of an individual or 500 penalty units in the case of a body corporate.

Timing

- The deadline for submissions on the draft legislation is 28 February 2020.

- The proposed commencement date is the day after Royal Assent.

[Sources: Exposure draft Bill: Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020: Use of terms "insurance" and "insurer"; draft explanatory memorandum]

Implementing FSRC recommendation 4.3: Consultation on draft legislation proposing to implement a deferred sales model for add-on insurance

Overview |

- **[Exposure draft] Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020: Deferred sales model for add-on insurance**

- **[Exposure draft] Corporations (Fees) Amendment (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020 (Fees Bill)**

- **[Exposure draft]: Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Regulations 2020: Deferred sales model for add-on insurance.**

Key Takeouts

- The government is consulting on draft legislation proposing to amend the ASIC Act to implement an industry wide deferred sales model for the sale of add-on insurance products in line with the government's response to Financial Services Royal Commission recommendation 4.3.

- The consultation follows the release of a proposal paper last year, seeking feedback on a proposed deferred sales model for add-on insurance.

- The deadline for submissions is 28 February 2020.

What has happened?

The government has released the following draft legislation (and accompany draft explanatory materials0 for consultation:

- [Exposure draft] Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020: Deferred sales model for add-on insurance
- [Exposure draft] Corporations (Fees) Amendment (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020 (Fees Bill)
- [Exposure draft regulations]: Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Regulations 2020: Deferred sales model for add-on insurance.

The deadline for submissions is 28 February.

Context: Implementing Financial Services Royal Commission recommendation 4.3

Financial Services Royal Commission recommendation 4.3 recommended that a Treasury-led working group should develop an industry-wide deferred sales model for the sale of any add-on insurance products (except policies of comprehensive motor insurance) and that the model should be 'as soon as is reasonably practicable'.

The draft Bill proposes to implement the government's response to this recommendation.

Overview: Proposed changes

Proposed changes include the following.

- **The draft Bill proposes to amend the ASIC Act to implement an industry wide deferred sales model for the sale of add-on insurance products** (ie insurance products that are sold alongside, or in relation to, the offer or sale of a principal good or service). The draft explanatory memorandum states that 'for add-on insurance products, the deferred sales model will replace the anti-hawking obligations'.
- **Purpose of introducing the deferred sales model?** Treasury says that the objective of the deferred sales model is to promote informed purchasing decisions by consumers in add-on insurance markets, by introducing a pause in the sales process between the consumer's purchase of the primary product and their decision to purchase add-on insurance. The deferral period will enable and encourage consumers to consider the merits of the insurance offered and to consult alternative products.
- **How will this work?**

[Note: Page 7 of the draft explanatory memorandum includes a diagram showing how the proposed deferral sales model for add-on insurance will operate.]

  - **Four day add-on insurance deferral period:** The proposed deferred sales model separates the sale of an add-on insurance product from that of the principal product or service. The proposed model bans the sale of add-on insurance product for at least four days after a consumer has entered into a commitment to acquire the principal product or service (the add-on insurance deferral period). It's proposed that the new requirement will apply across all sales channels – including in-person and online.

- **Six week period after the add-on insurance deferral period:** For the six weeks after the end of the four day add-on insurance deferral period, add-on insurance products may be sold to consumers, but communication with the consumer in forms other than writing is restricted. After this six weeks is up, the deferral sales model ends at which point, however, the draft explanatory memorandum points out that any contact made by the principal provider or a third party with the consumer will be subject to the anti-hawking provisions.

The draft explanatory memorandum notes that the proposed changes were 'developed taking into account the views' put forward in submissions to the proposal paper: Reforms to the sale of add-on insurance products released last year which outlined the government's proposed approach to implementing a deferred sales model.

[Note: For a summary of the proposed model put forward in the paper, see: Governance News 11/06/2019 at p18]

- **Prohibitions apply to both the principal provider and related third parties:** During the add-on insurance deferral period, a series of prohibitions apply in relation to the sale of the add-on insurance product and communicating with consumers in relation to the add-on insurance product. These prohibitions apply to both the principal provider and related third parties who sell add-on insurance products.

[Note: The draft explanatory memorandum (at p21) includes a table summarising the various prohibitions in the deferred sales model which apply in each time period.]

- **Exceptions?** It's proposed that the deferred sales model will not apply to: a) products that are the subject of an ASIC product intervention order which imposes a deferred sales period; b) comprehensive car insurance; c) products that the Minister exempts by regulations; d) products and entities that ASIC exempts by notifiable or legislative instrument; and e) products recommended by financial advisers.

- **Introduction of new offences:** It's proposed to make failure to comply with various aspects of the proposed new requirements an offence. For example, it's proposed that it will be both a criminal and civil offence to sell or offer an add-on insurance product to a consumer before the end the add-on insurance deferral period. In addition, a principal provider or a third party provider commits an offence if they offer an add-on insurance product for issue or sale, or request or invite the consumer to ask for, apply for, or purchase an add-on insurance product, after the consumer has informed them that they no longer wish to receive such offers, requests or invitations.

- **Consequential amendments:** Other proposed changes include the following.

  - amending the definition of chargeable matter in subsection 4(1) of the Corporations (Fees) Act 2001 to allow ASIC to charge a fee for an application by an entity to be exempted from the deferred sales model.

  - amending the definition of consumer to allow it to take its ordinary meaning in relation to services which are not financial services.

  - other consequential amendments to ensure the deferred sales model draws on general provisions that form part of the unconscionable conduct and consumer protection provisions in Part 2 Division 2 of the Australian Securities and Investments Commission Act 2001.

Draft regulations

The draft regulations propose to support the implementation of the industry wide deferred sales model for the sale of add-on insurance products by:

- prescribing when the consumer is taken to have entered into a commitment to obtain certain principal products or services. For example the draft regulations prescribe that for: a) credit cards; b) loans secured by a mortgage, charge or other security interest over residential property in Australia; c) loans for the purchase of a motor vehicle and d) loans for personal, domestic or household purposes, the consumer is taken to have entered into a commitment to acquire the product or service when the consumer is informed in writing that the credit facility is approved.

- amending the Corporations (Fees) Regulations 2001 to prescribe a fee that ASIC can charge to a person who applies to ASIC for an exemption from the deferred sales model.

The regulations may exempt a class of add-on insurance products from the deferred sales model on the recommendation of the Minister.

[Sources: Exposure draft Bill: Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020: Deferred sales model for add-on insurance; [Exposure draft] Corporations (Fees) Amendment (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020; Exposure draft regulations: Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Regulations 2020: Deferred sales model for add-on insurance; draft explanatory memorandum; draft explanatory statement]

Implementing FSRC recommendation 4.5: Consultation on draft legislation proposing to introduce a new duty on insureds to take reasonable care not to make a misrepresentation to the insurer on entering into, varying, extending or renewing a consumer insurance

Overview |

- **[Exposure draft] Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2020 Measures)) Bill 2020: FSRC Rec 4.5 (Duty of Disclosure to Insurer)**

- **[Exposure Draft] Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2020 Measures)) Regulations 2020: FSRC Rec 4.5 (Duty of Disclosure to Insurer)**

Financial Services Royal Commission recommendation 4.5 recommended that Part IV of the Insurance Contracts Act 1984 (Cth) (ICA) be amended, for consumer insurance contracts, to replace the duty of disclosure with a duty to take reasonable care not to make a misrepresentation to an insurer (and to make any necessary consequential amendments to the remedial provisions contained in Division 3).

The draft legislation released for consultation on 31 January — [exposure draft] Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2020 Measures)) Bill 2020: FSRC Rec 4.5 (Duty of Disclosure to Insurer) and draft regulations — proposes to implement the government's response to this recommendation.

Proposed changes

Proposed changes include the following.

- **New duty to take 'reasonable care'**: The draft Bill proposes to amend the ICA to introduce a duty for insureds to take reasonable care not to make a misrepresentation to the insurer on entering into, varying, extending or renewing a consumer insurance. This new duty will replace the existing duty of disclosure.

- **Reasons for the proposed change?** In line with Commissioner Hayne's recommendation, Treasury states that the 'the duty of disclosure is important to ensure that insurers are able to appropriately price the risks being underwritten through limiting the risk of fraud and misleading disclosures. However, the current requirements fall short of adequately safeguarding consumers against having their claims declined where they may have inadvertently failed to disclose their past circumstances or because insurers have failed to ask the right questions'.

- **Application:** The new duty applies only to contracts of insurance (including general and life insurance contracts) obtained for the insured's personal, domestic or household purposes.
- **Has the insured fulfilled the new duty?** In determining whether the insured has fulfilled the new duty to take reasonable care not to make a misrepresentation to the insurer, the draft explanatory memorandum says that 'regard must be had to all the relevant circumstances of a particular case'. The draft explanatory memorandum includes a non-exhaustive list of the range of factors that may be taken into account in determining whether the insured has fulfilled the new duty. These include: a) the type of consumer insurance contract in question, and its target market; b) explanatory material or publicity produced or authorised by the insurer; c) how clear, and how specific, any questions asked by the insurer were; d) how clearly the insurer communicated the importance of answering their questions and the possible consequences of failing to do so; and e) whether or not an agent was acting for the insured.
- **Fraudulent misrepresentation:** Consistent with the current law, any misrepresentation made fraudulently is taken to be a breach of the new duty, with the corresponding remedies under Division 3 of Part IV of the Insurance Contracts Act available to the insurer.

Timing

- **The due date for submissions** on the draft legislation is 28 February 2020
- **The proposed commencement date** for the (proposed) changes is 5 April 2021.

[Note: The draft Bill gives 1 July 2020 as the commencement date, while the draft explanatory memorandum gives 5 April 2021. Treasury has been contacted for clarification and has confirmed that the proposed date on which the key changes will commence is 5 April 2021.]

The explanatory memorandum notes that the proposed commencement date aligns with the date of application of both:

- the new Design and Distribution Obligations in Schedule 1 to Treasury Laws Amendment (design and Distribution Obligations and Product Intervention Powers) Act 2019; and
- the proposed date of application of the unfair contract terms regime for insurance contracts in Schedule 1 to the Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2019 Measures)) Bill 2019 which was introduced into the House of Representatives on 28 November 2019 (to implement Financial Services Royal Commission recommendation 4.7).

[Sources: [exposure draft] Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2020 Measures)) Bill 2020: FSRC Rec 4.5 (Duty of Disclosure to Insurer); Exposure Draft Bill – Corporations (Fees) Amendment; draft regulations; draft explanatory memorandum; draft explanatory statement]

Implementing an 'additional commitment' in response to FSRC recommendation 7.2: Consultation on draft legislation proposing give ASIC a directions power

Overview | [Exposure draft] Financial Sector Reform (Hayne Royal Commission Response — Stronger Regulators (2020 Measures)) Bill 2020: FSRC Rec 7.2 (ASIC Directions)

Context: implementing the government's additional commitment in response to recommendation 7.2

- Financial Services Royal Commission recommendation 7.2 recommended that the recommendations of the ASIC Enforcement Review Taskforce (made in December 2017) that relate to self-reporting of contraventions by financial services and credit licensees should be carried into effect.
- The government's response to the Commission's recommendations (released on 4 February 2019) included a commitment in response to recommendation 7.2, to provide the Australian Securities and Investments Commission (ASIC) with powers to give directions to Australian Financial Services Licence

(AFSL) and Australian Credit Licence (ACL) holders consistent with the recommendations of the ASIC Enforcement Review.

- In August 2019, the government released an implementation roadmap setting out its proposed timeframes for implementing its response to the Commission's recommendations. The roadmap listed providing ASIC with directions powers as an 'additional commitment' in response to recommendation 7.2, to be consulted on and introduced by 30 June 2020.
- On 31 January the government released draft legislation — [exposure draft] Financial Sector Reform (Hayne Royal Commission Response — Stronger Regulators (2020 Measures)) Bill 2020: FSRC Rec 7.2 (ASIC Directions) — proposing to implement this additional commitment.

Proposed changes

- **Provide ASIC with a directions power:** The draft Bill proposes to implement part of the Government's response to recommendation 7.2 by providing ASIC with powers to give directions to financial services licensees and credit licensees in order to prevent or address suspected breaches of financial services law or credit legislation. The draft Bill provides a non-exhaustive list of directions that ASIC may give to AFS licensees or credit licensees.
- **When can ASIC give a direction?** It's proposed that ASIC will be able to give a direction to:
  - an AFS licensee if ASIC has a reason to suspect that the licensee has, is, or will engage in conduct that contravenes the financial services law
  - a credit licensee if ASIC has a reason to suspect that a licensee has, is or will engage in conduct that contravenes the credit legislation.
  - The draft explanatory memorandum explains that the directions are 'designed to be quick and efficient responses to the conduct of AFS licensees and credit licensees, aimed at early regulatory intervention in order to better protect consumers' and that therefore, the threshold for triggering a direction is relatively low. The threshold for triggering a direction is that ASIC must have a 'reason to suspect' (not 'reason to believe') that a licensee has, is or will engage in contravening conduct.
- **Procedure when giving a direction:**

[Note: The diagram on Page 4 of the draft explanatory memorandum summarises the proposed directions procedure.]

  - It's proposed that a direction must be given to a licensee in writing, and must be directed toward either addressing or preventing the suspected contravention that triggered the direction or preventing a similar or related contravention. Likewise, a variation or revocation of a direction must be given to a licensee in writing.
  - It's proposed that before giving a direction, other than an interim direction, ASIC must give the licensee an opportunity to appear, or be represented, at a hearing. In addition, it's proposed that ASIC must also give the licensee an opportunity to make submissions to ASIC in relation to the matter to which the direction relates.
  - It's proposed that ASIC can vary a direction or an interim direction that it has given to an AFS licensee or credit licensee if ASIC considers that this is necessary and appropriate, but that before doing so, ASIC must give the licensee an opportunity to appear or be represented at a hearing.
  - If ASIC intends to make a direction to a licensee who is a body that is regulated by APRA, it's proposed that ASIC must consult APRA before that direction is given to a licensee. However, a failure to consult with APRA will not invalidate any direction given.

- After giving a direction to a licensee, it's proposed that ASIC be required to publish a copy of the direction on the ASIC website as soon as practicable. ASIC does not need to publish a copy of an interim direction on their website.

- **Interim directions:** It's proposed that ASIC may give an interim direction to a licensee if ASIC considers that a delay in giving a direction would be prejudicial to the public interest. An interim direction will expire at the end of a 21 day period from the day on which it is given, or if a direction in relation to the same suspected contravention is given to the licensee.
- **Effect?** It's proposed that a direction or interim direction to a licensee will take effect when it is given to the licensee, and that compliance will be required from that time. Likewise it's proposed that any variation or revocation of the direction will take effect when it is given to the licensee.
- **Compensation scheme:** It's proposed that ASIC will be able to direct a licensee to address a suspected contravention by way of implementing a compensation scheme to compensate those who suffered loss/damage due to the suspected contravention. The draft Bill sets out a number of matters which ASIC will have discretion to include in a direction about a compensation scheme.
- **Civil penalty:** The Bill proposes to make consequential amendments to the Corporations Act 2001 (Cth) in order to specify that a contravention of a direction or interim direction is a civil penalty provision.
- **ASIC's decisions are reviewable:** A decision by ASIC or a delegate to give a direction, interim direction or an approval of a person nominated by a licensee to do a specified task, is 'subject to the usual safeguards'. This includes administrative review, judicial review and consideration in appropriate circumstances by the Commonwealth Ombudsman.

Timing

- **The due date for submissions** to on the draft legislation is 28 February.
- **The proposed commencement date** for the (proposed) changes is the day after Royal Assent.

[Sources: Exposure draft: Financial Sector Reform (Hayne Royal Commission Response—Stronger Regulators (2020 Measures)) Bill 2020: FSRC rec 7.2 (ASIC directions); Draft explanatory memorandum]

Banks have made good progress, and the sector remains committed to continuing to improve says ABA: The Australian Banking Association (ABA) has issued an update one year on from the Financial Services Royal Commission, recapping the changes implemented to date in the banking sector

The Australian Banking Association (ABA) has issued an update, one year on from the Financial Services Royal Commission, recapping the changes implemented to date in the banking sector including, among others: changes to 'fix' the culture within banks (eg launching the new Banking Code of Practice); regulatory changes (eg the implementation of the banking executive accountability regime); and other actions implemented by the sector to simplifying businesses and 'ensure a strong focus on core banking'.

The ABA has also published a table showing the progress made to date on implementing the Commission's recommendations.

'One year on from the [Financial Services] Royal Commission the banking industry has tougher rules imposed by the Government and regulators, a back to basics approach to banking which is squarely centred on the customer and a renewed focus on fixing culture' the statement reads.

CEO of the Australian Banking Association Anna Bligh is quoted as saying that though much progress had been made to address the issues identified over the course of the Commission, there is more to be done.

'One year on from the delivery of his final report, a great deal of work has been completed to fulfil to this commitment. To make things right banks have this year alone set aside $5.8 billion on refunding customers or related remediation costs. Banks have a new Code of Practice which has real teeth, with independent monitoring and enforcement and will be strengthened even further this year. We haven't stopped there, we've overhauled the way we pay staff by abolishing sales targets to ensure we always, at all times, put the customer first. The industry knows there is still much work to be done to earn back the trust of the Australian people and will continue to remain focussed on this task' Ms Bligh said.

[Source: ABA media release 30/01/2020; FSRC one year on update]

In Brief | The Consumer Action Law Centre has cautioned against watering down Commissioner Hayne's recommendations one year on from the release of the Final Report: 'Commissioner Hayne found that greed and a focus on sales and profits drove significant misconduct. This will continue unless the Government and regulators take a firm stance against misconduct and regulatory loopholes. These reforms will only work if they honour the spirit, and not just the letter, of Hayne's recommendations. At the end of this bumper crop of legislative reform, the Government must ensure there are no gaps and loopholes' the statement reads

[Source: CALC media release 31/01/2020]

In Brief | The AFR reports that ASIC expects to launch another 20 cases related to the Hayne Commission in the first half of 2020. Deputy Chair Daniel Crennan is quoted as saying that he expects the 'it will be busier the next six months than the last six months'. Mr Crennan also reportedly confirmed that ASIC 'will be in a position to explain why we don't pursue cases' and that the regulator expects questions of that nature during Senate estimates hearings

[Source: [registration required] The AFR 03/02/2020]

In Brief | Legal challenge on banning grandfathered commissions will not go forward? The Association of Independently Owned Financial Advisers has reportedly failed to raise the required capital to fund a legal challenge to the banning of commissions. The AFR quotes AIOFP Executive Director Peter Johnston as saying that industry sentiment has shifted post-Hayne, 'after initially strongly protesting against banning grandfathered revenue three years ago, most have accepted they need to move forward…History will show this will be the best outcome for all concerned'

[Sources: [registration required] The AFR 29/01/2020; 30/01/2020; Financial Standard 30/01/2020]

Other Developments

APRA member Geoff Summerhayes has cautioned the PHI sector that the 'industry's current trajectory is unsustainable'

Overview | Speech by APRA Member Geoff Summerhayes to the Members Health Directors Professional Development Program February 2020

Key Takeouts

- **The sustainability challenges facing the private health insurance (PHIs) sector are increasing and 'industry's current trajectory is unsustainable'.**
- **One three providers will be viable in 2022?** Mr Summerhayes said that APRA's 'immediate prudential concern…is the rising disparity between growth in claims costs and premiums. If the gap between the two remains at around two percentage points a year, APRA's analysis indicates that only three private health insurers will still have a sustainable business model by 2022. None of those three are the smaller, not-for-profit funds represented by Members Health'.

- **Smaller PHIs are most vulnerable to these challenges and APRA expects them to take action to respond (including pursuing a merger)**
- **Boards should be ready to answer the following questions (which APRA will be asking when assessing the credibility of recovery plans):** a) Do we have the right expertise and capability in our organisation? b) Do we have a sustainable business model? Can we reverse the trend? If not, what are we doing about it? c) Do we have a unique product offering, or anything that gives us a competitive advantage? d) Are our risk management capabilities adequate for our operating environment?; and e) Are we taking proactive steps to guarantee a bright future, or simply relying on Government intervention?
- **Time for an independent PHI review?** Mr Summerhayes said that APRA would support an independent review of the current system. 'Its starting point should be this fundamental question: what is the role of private health insurance in Australia?' he said.
- **Action is required:** Mr Summerhayes concluded his speech by saying, 'When not even substantial taxpayer subsidies and the Medicare levy surcharge can convince a growing number of policyholders that private health insurance represents value-for-money, it's time for a rethink. For now, PHIs are profitable, well capitalised and comfortably able to meet their obligations to policyholders, but that will not remain the case much longer without major structural and policy reforms. We should not wait for the industry's stable but serious condition to become critical before operating to save it'.

In his recent speech to the members health directors professional development program, Australian Prudential Regulation Authority (APRA) member Geoff Summerhayes spoke about the challenges facing the private health insurance (PHI) sector and the need for urgent (and collective) action to address them.

The headline message was that though 'for now, PHIs are profitable, well capitalised and comfortably able to meet their obligations to policyholders…that will not remain the case much longer without major structural and policy reforms. We should not wait for the industry's stable but serious condition to become critical before operating to save it'.

Further, Mr Summerhayes said that collective action from industry's major stakeholders (eg government, insurers, regulators, medical practitioners and others) will be required.

Some Key Points

The 'sustainability challenge' facing the sector is intensifying

- **Little has changed in two years ('which is not the positive endorsement it first appears'):** Mr Summerhayes said that little had changed in the two years since he last addressed the event. He added that though profitability remains strong, despite a slight decline over the past year, and PHIs continue to be well-capitalised, just as they were in 2018, the challenges facing the industry have intensified. 'The negative trends that are slowly strangling the industry's sustainability have also not improved, in spite of APRA's increased supervisory intensity and Government reforms aimed at addressing the affordability conundrum'.
- **Mr Summerhayes said that in the two years since he last addressed the event, the factors threatening the sustainability of PHIs have 'only become more acute'.** These challenges include:
    - the fact that younger, healthier people are abandoning private health cover (another 127,000 policyholders in the 20-34 age group left the private system in the past two years while there has been a rise in the policyholders in the 70-84 age group

- hospital coverage has fallen from 45.5% of the population in March 2018 to 44.1% today (which is the lowest level since June 2007

- the proportion of the population covered by private health insurance is likely to fall further. APRA predicts that on current trends, the level of hospital cover will have dropped another 1.6% or 184,000 policyholders, by 2025.

- underlying costs are increasing (ie the price of medical treatments and equipment, and an ageing membership base that makes more expensive claims more often). Mr Summerhayes said that over the past few years, the underlying claims cost has risen at an average of about 5% a year, putting further upward pressure on premiums.

- **'The Grattan Institute's description of a "death spiral" may be dramatic, but it's also pretty accurate':** Mr Summerhayes said that on current trends, APRA predicts we're only a few years away from seeing private health insurers forced to merge or fold, with the smaller insurers, represented in this room, likely to be the most vulnerable' Mr Summerhayes said.

Prudential concerns about the state of the sector

- **APRA has 'prudential concerns' about the state of the private health insurance industry:** Mr Summerhayes said that though two years ago, APRA had no prudential concerns about the state of the private health insurance industry, but that this has changed. 'My blunt message today is that it's no longer the case' he said.

- **Disparity between claims costs and premiums is APRA's more immediate prudential concern:** Mr Summerhayes said that APRA's 'immediate prudential concern…is the rising disparity between growth in claims costs and premiums. If the gap between the two remains at around two percentage points a year, APRA's analysis indicates that only three private health insurers will still have a sustainable business model by 2022. None of those three are the smaller, not-for-profit funds represented by Members Health'.

Industry response to the 'sustainability challenge, an update on APRA's assessment of industry recovery plans

- **APRA to assess the 'credibility' of recovery plans:** Mr Summerhayes noted that APRA had previously asked insurers to submit a their 'recovery plans' (including a 'Plan B') to the regulator, with 'at risk' PHIs asked to sound out a potential merger partner in case their plan isn't successful. He said that the plans are being submitted in three tranches: the first tranche of the recovery plans, from the 'highest risk' insurers were submitted in December; plans from bigger PHIs are due 30 March; and the remainder due to submit their plans by the end of June. Mr Summerhayes said that APRA plans to 'assess these recovery plans, and intensify supervision according to each plan's comprehensiveness and credibility, consistent with our risk-based approach'.

- **Some 'positive signs' from larger PHIs**: Mr Summerhayes said that APRA has observed 'positive signs' from some PHIs that are tackling the sustainability challenge head-on' and gave some examples of the 'more successful strategies' being employed. They include: a) enhancing value for younger and healthier members outside of typical hospital settings; b) lowering claims costs through alternative models of care and preventative health; and c) the use of partnerships and technologies to manage operational costs. Mr Summerhayes observed that it is 'regrettable' (if unsurprising given their 'deeper pockets) that it is the larger PHIs that have been most active in these areas to date, given the challenges facing smaller PHIs.

Message to smaller PHIs

- **Smaller PHIs are expected to take action (despite the challenges):** Mr Summerhayes said that smaller PHIs have their own 'natural advantages' eg specialised knowledge of niche markets, deep connections to local communities and a not-for-profit ethos that appeals to many customers, but also less ability to absorb the cost pressures or invest in the types of innovative service and technological solutions that the top five PHIs are exploring. He added however, that this 'will not be accepted by APRA as an excuse for inaction. Rather, it makes it all the more important that PHIs concentrate on those lower-cost factors they can better control, particularly in the areas of governance, business planning and risk management'.

- **Smaller PHIs should consider pursuing a merger:** Mr Summerhayes said that 'there is, of course, a way for smaller PHIs to very quickly increase scale and financial resourcing – and that is to pursue a merger'. 'When I last spoke to you, I mentioned that APRA had yet to form a view on whether industry consolidation in private health insurance is necessary to protect policyholders' interests. That's broadly still true, but as smaller PHIs take limited action to address affordability challenges, we're increasingly coming to the conclusion that it's probably inevitable' he said. He added that APRA has begun preparing to ensure it has sufficiently developed processes and powers 'to facilitate – or force, if necessary – mergers or transfers of policies if we come to the view that policyholders' interests are under threat'. Mr Summerhayes said that the government is currently considering the issues around APRA's current licensing and enforcement abilities noted in last year's Capability and Enforcement Reviews.

Questions PHI boards should be ready to answer

Mr Summerhayes listed a number of questions PHI boards should be asking, noting that when assessing the credibility of PHI's recovering plans and considering its supervisory response, APRA would ask the same questions. The questions are as follows:

- Do we have the right expertise and capability in our organisation?

- Do we have a sustainable business model? Can we reverse the trend? If not, what are we doing about it?

- Do we have a unique product offering, or anything that gives us a competitive advantage?

- Are our risk management capabilities adequate for our operating environment?

- Are we taking proactive steps to guarantee a bright future, or simply relying on Government intervention?

New 'MySuper' type heatmap tool (for internal use) will assist in assessing the credibility of recovery plans?

Mr Summerhayes said that assessment of the recovery plans will be assisted by work underway at the regulator to refine the metrics used internally to better identify which 'PHIs face the gravest sustainability challenges'. Mr Summerhayes said that the new tool will operate in a similar way to the MySuper heatmap but will only be used in internal analysis/discussions with PHIs.

Ultimately, collective action to address the 'root causes' of the challenges facing the industry is required

- **APRA can only do so much:** Mr Summerhayes said that by 'strengthening and being more active in enforcing the prudential framework for private health insurance – including the current review of capital standards – APRA is giving PHIs the best possible chance of remaining viable in a challenging environment. But "resilient" is not the same as "impervious". Unless the root causes that are driving up premiums and costs and pushing down coverage levels are addressed, all APRA is really doing is just buying time for vulnerable PHIs, and delaying the inevitable mergers and exits to come.'

- **Time for the government to launch an independent review?** Summerhayes said that APRA would support an independent review of the system. 'Its starting point should be this fundamental question: what is the role of private health insurance in Australia?' he said. Mr Summerhayes added that given the scale of the sustainability challenges facing the sector, and given that 'industry's current trajectory is unsustainable', APRA is of the view that 'all key policy and regulatory settings should be up for discussion'. These include: a) the risk equalisation tool; b) a review of the ongoing viability of the community rating model; c) what services can be covered; d) the way premiums are set; e) the way prices are set between PHIs and medical providers; f) the role of private health insurance in mental health; g) the rules around out-of-hospital treatment; and h) the management of chronic conditions.

- **Mr Summerhayes said that APRA does not have a 'formal position' on these issues:** Mr Summerhayes clarified that 'APRA has no formal position on the risk equalisation pool, nor any of these other matters: they are, appropriately, decisions for Government. And we also recognise there are potential downsides to altering or removing some of the current settings…These are complex issues and there are no easy answers. What we do have a firm position on is that the industry's current trajectory is unsustainable; and that while private health insurers may be the ultimate victims of the so-called death spiral, policyholders will be the first casualties through higher premiums and reduced benefits'.

- **Collective and urgent action is required to 'save' the sector?** Mr Summerhayes concluded his address by underlining the need for collective action by all industry's major stakeholders — government, insurers, regulators, medical practitioners, hospital groups, as well as device manufacturers, pharmaceutical companies and the views of health fund members — to address the challenges facing the industry. 'All have a role to play in keeping the system affordable, accessible and sustainable, and no single stakeholder can fix the issues in isolation' he said.

  'When not even substantial taxpayer subsidies and the Medicare levy surcharge can convince a growing number of policyholders that private health insurance represents value-for-money, it's time for a rethink. For now, PHIs are profitable, well capitalised and comfortably able to meet their obligations to policyholders, but that will not remain the case much longer without major structural and policy reforms. We should not wait for the industry's stable but serious condition to become critical before operating to save it' he said.

[Source: Speech by APRA Member Geoff Summerhayes to the Members Health Directors Professional Development Program 04/02/2020; [registration required] The Australian 05/02/2020;

Stamping fee exemption inquiry: Treasury guidance for submissions

Context: On 27 January Treasurer Josh Frydenberg announced a four week inquiry into the merits of the current stamping fee exemption in relation to listed investment entities (see: Governance News 29/01/2020 at p13).

Guidance for submissions released: On 29 January, Treasury released guidance for submissions to the inquiry.

Details: Treasury is seeking information on current industry practices and trends, and evidence on how the current listed investment entities exemption operates within the context of: a) the quality of advice received by retail investors from stockbrokers and financial advisers, and, any subsequent impacts on investor outcomes; b) capital markets and industry participants, including their efficiency and competitive dynamics both locally and overseas; and c) the broader economy.

Timeline: The deadline for submissions is 20 February 2020.

[Source: Treasury media release 29/01/2020]

In Brief | 'World first' (voluntary) Code of Practice: AFIA has released a draft buy-now-pay-later (BNPL) Code of Practice for consultation that proposes to set minimum standards for BNPL companies. The due date for submissions 11 March. AFIA says the planned implementation date for the new Code (once finalised) is 1 July 2020, though this may be impacted by the consultation process

[Sources: AFIA media release; AFIA draft code of practice for BNPL providers; [registration required] The AFR 29/01/2020; [registration required] The Australian 28/01/2020; The ABC 29/01/2020; BusinessInsider 29/01/2020]

In Brief | ASIC confirms there was no conflict and no wrongdoing: The Australian reports that an ASIC internal review of the circumstances around former ASIC senior executive Michael Saadat's recruitment by Afterpay, after he oversaw ASIC's investigation into six BNPL providers (including Afterpay), has found there was no wrongdoing

[Source: [registration required] The Australian 29/01/2020]

Accounting and Audit

United Kingdom | The UK government is reportedly considering giving the Financial Reporting Council powers to prevent accounting firms from providing non-audit services to larger private companies (though which companies would fall into this category is as yet unclear)

The FT reports that the UK government is considering giving the Financial Reporting Council (FRC) new powers to prevent accounting firms, including the 'big four' (PwC, Deloitte, KPMG and EY) from providing non-audit services (eg consulting, remuneration and tax advice) to the large private companies they audit. In practice, the FT comments, this will mean that larger private firms will either have to replace their auditor or rethink their roster of consultants.

In addition, the FT reports that scope of the FRC's annual review of audit quality would be extended to include private companies of 'significant public interest' (which would open the door to possible enforcement action by the FRC).

The FT quotes FRC Chair Simon Dingemans as commenting that 'in a world where we are trying to improve governance, reporting and audit standards across the market, a debate about whether significant private companies should be held to the same standards [as public companies] seems wholly appropriate, particularly given the large numbers of employees, customers and suppliers'.

According to The FT, it is as yet unclear which companies will be subject to the proposed measures (if implemented), though it's suggested that they would likely cover businesses captured by the Wates Principles on Corporate Governance, which are companies that employ more than 2,000 people, or have a turnover of more than £200m and a balance sheet of £2bn.

Reportedly, the proposed measures have received a mixed reception from accounting firms. The FT quotes Deloitte as welcoming the changes on the condition that there is sufficient 'transition time' to 'work through any changes'. The FT quotes PwC as saying that the 'introduction [of the measures] . . . would lead to complexity for companies and their audit committees as it is unclear to which companies the definition would extend.'

In addition, an unnamed 'big four' CEO is quoted as raising concerns about whether the FRC is in a position to take on the additional work, 'The FRC can barely handle its existing workload' the CEO is quoted as saying.

[Source: [registration required] The FT 24/01/2020]

Appendix

FSRC legislation summary table: Overview — consultation on draft legislation to implement various Hayne recommendations released 31 January 2020 for consultation

Overview — consultation on draft legislation to implement various Hayne recommendations released 31 January 2020 for consultation.

The due date for submissions to the consultation is 28 February 2020.

[Note: You can find the draft legislation listed in the table below on the Treasury website here.]

Draft legislation title	FSRC recommendations	Key changes	Proposed commencement date
▪ [Exposure draft] Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020: FSRC rec 1.6, 2.7, 2.8, 2.9 and 7.2, (Reference checking and information, sharing, breach reporting and remediation)	▪ 1.6 (misconduct by mortgage brokers) ▪ 2.7 (reference checking and information sharing) ▪ 2.8 (reporting compliance concerns) ▪ 2.9 (misconduct by financial advisers) ▪ 7.2 (implementation of the ASIC Enforcement Review recommendations) (partial response)	Broadly, the draft Bill proposes to: a) introduce new reference checking and information sharing obligations for AFSL holders and ACL holders; b) strengthen the breach reporting regime for financial services and credit licensees; c) introduce new requirements for investigating and remediating misconduct; and introduce new penalty provisions for non-compliance.	1 July 2020
▪ [Exposure draft Bill] Financial Sector Reform (Hayne Royal Commission Response— Protecting Consumers (2020 Measures)) Bill 2020: Avoidance of life insurance contracts (FSRC Rec 4.6)	▪ 4.6 (avoidance of life insurance contracts)	The draft Bill proposes to amend the Insurance Contracts Act 1984 (ICA) to limit the circumstances in which an insurer can avoid a contract of life insurance because of a non-fraudulent misrepresentation or non-fraudulent failure to comply with the duty of disclosure by the insured to the insurer.	The day after the legislation receives Royal Assent.

Draft legislation title	FSRC recommendations	Key changes	Proposed commencement date
▪ [Exposure draft Bill] Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020: Caps on Commissions	▪ 4.4 (cap on add-on insurance commissions)	The draft Bill proposes to cap the amount of add-on insurance commissions that may be paid to a vehicle dealers in relation to add-on risk products such as tyre and rim insurance, mechanical breakdown insurance and consumer credit insurance (for the credit facility) supplied in connection with the sale or long-term lease of a motor vehicle.	The day after the legislation receives Royal Assent.
▪ [Exposure draft] Financial Regulator Assessment Authority Bill 2020 (Assessment Authority Bill) ▪ [Exposure draft] Financial Sector Reform (Hayne Royal Commission Response— Stronger Regulators (2020 Measures)) Bill 2020: FSRC rec 6.14 (Financial Regulator Assessment Authority) (Stronger Regulations Bill)	▪ 6.14 (new independent oversight authority for APRA and ASIC)	The draft legislation proposes to establish a new oversight body — the Financial Regulator Assessment Authority — to oversee the effectiveness of APRA and ASIC. The draft legislation specifies the funds and powers of the proposed new Authority	1 July 2020
▪ [Exposure draft] Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020 FSRC Rec 1.15	▪ 1.15 (enforceable industry code provisions)	The draft Bill proposes to 'build on' the existing codes framework contained in the Corporations Act 2001 (Cth) (Corporations Act) and the National Consumer Credit Protection Act 2009 (Credit Act) to allow ASIC to designate enforceable code provisions in	1 July 2020

Draft legislation title	FSRC recommendations	Key changes	Proposed commencement date
(Enforceable Code Provisions)		approving financial sector industry codes. The Bill also proposes to introduce a framework for establishing mandatory codes of conduct for the financial services industry through regulations.	
▪ [Exposure draft] Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020: FSRC rec 2.1 (ongoing free arrangements) ▪ [Exposure draft] Financial Sector Reform (Hayne Royal Commission Response— Protecting Consumers) (Ongoing Fee Arrangements) Regulations 2020: FSRC rec 2.1	2.1 (ongoing fee arrangements: annual renewal and payment)	The draft Bill proposes to target the issue of fee for no service conduct by requiring financial services providers that receive fees to: a) seek annual renewal from clients for all ongoing fee arrangements (ie new and existing ongoing fee arrangements will need to be renewed annually); b) require fee recipients to disclose in writing the total fees that will be charged; c) set out the services that will be provided during the following 12 month period; and d) obtain written consent before fees under an ongoing fee arrangement can be deducted from a client's account. The draft regulations outline the record keeping compliance requirements for fee recipients to support the operation of the draft Bill.	1 July 2020
▪ [Exposure draft] Financial Sector Reform (Hayne Royal Commission response — Protecting Consumers (2020	▪ 2.2 (disclosure of lack of independence)	The draft Bill proposes to introduce a new requirement for providing entities (ie a financial services licensee or authorised representative) to disclose in writing to their (retail) client it	1 July 2020

Draft legislation title	FSRC recommendations	Key changes	Proposed commencement date
Measures)) Bill 2020: FSRC Rec 2.2 (disclosure of lack of independence)		they are not independent and why that is the case.	
▪ [Exposure Draft] Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020: RSE licence condition — no other duty (FSRC rec 3.1)	▪ 3.1 (trustee of a superannuation fund should be prohibited from having any obligations other than those arising from or in the course of its performance of its duties as trustee of a superannuation fund)	The draft Bill proposes to impose an additional condition on RSE licences held by a body corporate trustee. The condition would prohibit the RSE licensee from having a duty to act in the interests of another person, except in the course of: a) performing the RSE licensee's duties and exercising the RSE licensee's powers' as a trustee of a registrable superannuation fund; or b) providing personal advice.	1 July 2020
▪ [Exposure draft Bill] Financial Sector Reform (Hayne Royal Commission Response— Protecting Consumers (2020 Measures)) Bill 2020: fees (FSRC Rec 3.2 and 3.3)	▪ 3.2 (no deducting advice fees from MySuper Accounts) ▪ 3.3 (limitations on deducting advice fees from choice accounts)	The draft Bill proposes to remove a superannuation trustee's capacity to charge advice fees from MySuper products and remove the capacity of a superannuation trustee to charge advice fees to a member (other than fees for intra-fund advice) unless certain conditions are satisfied.	1 July 2020
▪ [Exposure draft] Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020: Hawking of Financial Products	▪ 3.4 (banning hawking of superannuation products) ▪ 4.1 (banning the hawking of insurance products)	The draft Bill proposes to 'strengthen the existing hawking prohibition' in the Corporations Act 2001 (Cth) by introducing one general prohibition for the hawking of all financial products. The draft regulations propose to amend the	1 July 2020

Draft legislation title	FSRC recommendations	Key changes	Proposed commencement date
▪ [Exposure draft] Financial Sector Reform (Hayne Royal Commission Response— Protecting Consumers (2020 Measures)) Regulations 2020: Hawking of financial products		Corporations Regulations 2001 (Cth) to remove exceptions to the hawking prohibition and to ensure that the Corporations Regulations continue to operate effectively.	
▪ [Exposure draft Bill] Financial Sector Reform (Hayne Royal Commission Response— Stronger Regulators (2020 Measures)) Bill 2020: ASIC regulation of superannuation (FSRC Rec 3.8, 6.3, 6.4, 6.5) ▪ [Exposure draft Regulations] Financial Sector Reform (Hayne Royal Commission Response— Stronger Regulators) (Regulation of Superannuation) Regulations 2020	▪ 3.8 (adjustment of APRA and ASIC's roles) ▪ 6.3 (general principles of co-regulation) ▪ 6.4 (ASIC as conduct regulator) ▪ 6.5 (APRA to retain functions)	Broadly, the draft Bill proposes to: a) expand ASIC's role in superannuation to include protecting consumers from harm and market misconduct; b) extend the AFSL regime to cover a broader range of activities undertaken by APRA-regulated superannuation trustees (through the creation of a new type of financial service: providing a superannuation trustee service); c) extend the existing indemnification provisions in the SIS Act to prevent trustees and directors from using trust assets to pay a criminal, civil or administrative penalty incurred through contravention of a provision of the Corporations Act or ASIC Act; d) require courts to consider the impact of penalties on beneficiaries. The draft regulations propose to remove certain exemptions from the requirement	1 July 2020

Draft legislation title	FSRC recommendations	Key changes	Proposed commencement date
		to hold an AFSL to provide financial services, and to make other minor amendments in support of the broader reforms to the roles and responsibilities of the superannuation industry regulators as set out in the draft Bill.	
▪ [Exposure draft Bill] Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020: Use of terms 'insurance' and 'insurer'	'Additional commitment' in response to 4.2 (restrict the ability of firms to use terms such as 'insurer' and 'insurance')	The draft Bill proposes to restrict the ability of firms to use the terms 'insurer' and 'insurance' to only those firms that have a 'legitimate interest' in using terminology and to introduce penalties to non-compliance.	▪ The day after the legislation receives Royal Assent.
▪ [Exposure draft] Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020: Deferred sales model for add-on insurance (Add-on insurance Bill) ▪ [Exposure draft] Corporations (Fees) Amendment (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020 (Fees amendment Bill)	4.3 (deferred sales model for add-on insurance)	The draft Bill proposes to amend the ASIC Act to implement an industry wide deferred sales model for the sale of add-on insurance products (ie insurance products that are sold alongside, or in relation to, the offer or sale of a principal good or service). It's also proposed to make failure to comply with various aspects of the proposed new requirements an offence. The draft regulations propose to support the implementation of the industry wide deferred sales model for the sale of add on insurance products by: a) prescribing when	▪ (Add-on insurance Bill): The day after the end of the period of 12 months beginning on the day the legislation receives the Royal Assent. ▪ Fees amendment Bill: Immediately after the commencement of the Add-on Insurance Bill (subject to the passage of the Bill)

Draft legislation title	FSRC recommendations	Key changes	Proposed commencement date
▪ [Exposure draft regulations]: Financial Sector Reform (Hayne Royal Commission Response— Protecting Consumers (2020 Measures)) Regulations 2020: Deferred sales model for add-on insurance.		the consumer is taken to have entered into a commitment to obtain certain principal products or services; b) amending the Corporations (Fees) Regulations 2001 to prescribe a fee that ASIC can charge to a person who applies to ASIC for an exemption from the deferred sales model.	
▪ [Exposure draft] Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2020 Measures)) Bill 2020: FSRC Rec 4.5 (Duty of Disclosure to Insurer) ▪ [Exposure Draft] Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2020 Measures)) Regulations 2020: FSRC Rec 4.5 (Duty of Disclosure to Insurer)	4.5 (duty to take reasonable care not to make a misrepresentation to an insurer)	The draft Bill proposes to introduce a duty for insureds to take reasonable care not to make a misrepresentation to the insurer on entering into, varying, extending or renewing a consumer insurance. This new duty will replace the existing duty of disclosure.	5 April 2021 [Note: The draft Bill gives 1 July 2020 as the commencement date, while the draft explanatory memorandum gives 5 April 2021. Treasury has been contacted for clarification and has confirmed that the proposed date on which the key changes will commence is 5 April 2021.]
▪ [Exposure draft] Financial Sector Reform (Hayne Royal Commission Response — Stronger Regulators	▪ 7.2 (implementation of the ASIC Enforcement Review recommendations) (partial response)	The draft Bill proposes to implement part of the government's response to recommendation 7.2 by providing ASIC with powers to give directions to financial	The day after the legislation receives Royal Assent.

Draft legislation title	FSRC recommendations	Key changes	Proposed commencement date
(2020 Measures)) Bill 2020: FSRC Rec 7.2 (ASIC Directions)		services licensees and credit licensees in order to prevent or address suspected breaches of financial services law or credit legislation.	