



Rebuilding trust

**KPMG's overview of the Royal
Commission Final Report into Misconduct
in the Banking, Superannuation and
Financial Services Industry**

February 2019

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Introduction

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Commission**) released its *Final Report* on Monday 4 February 2019 (**Final Report**). The *Final Report* needs to also be read in conjunction with the observations and findings of the Interim Report.

It has been well documented that the Commission received over 10,000 public submissions and held 68 days of hearings. The *Final Report* seeks to take what has been learned in respect of each part of the financial services industry that has been examined and identify issues, causes; and responses / recommendations. The Commission refers 24 instances of misconduct to the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Association (APRA) for prosecution.

In its *Final Report*, the Commission continues to identify dishonesty and greed as the two main drivers behind the misconduct to date, declaring that the pursuit of short-term profit has been too often prioritised at the expense of basic standards of honesty.

The Commission's work has four clear observations: the connection between conduct and reward; the asymmetry of power and information between financial services entities and their customers; the effect of conflicts between duty and interest; and holding entities to account.

The Commission sets out its final recommendations and findings about the Australian banking and financial services sector under seven broad categories in the *Final Report*, each of which is summarised in more detail below.



Banking



Commission focussed on seven main themes in relation to banking

The Commission made recommendations in relation to seven core areas of banking, including consumer lending (direct and through intermediaries), access to banking services, lending to small and medium enterprises, enforceability of industry codes and processing and administrative errors.

Within these seven core areas, the Commission made a total of 17 recommendations with respect to banking. These are summarised below.

Consumer lending

The report highlighted the importance of the Treasury's observation that if 'appropriately managed, ensuring the industry consistently meets the requirements of existing laws will likely enhance rather than detract from macroeconomic performance' and recommended that the National Consumer Credit Protection Act (**NCCP Act**) should not be amended to alter the obligation to assess unsuitability, rather 'apply the law as it stands' (R1.1)

The Commission stated that banks tended to conflate the two requirements of the NCCP Act and considered that both income and expenses must be inquired about and verified. The report reiterated comments made in the interim report that the Household Expenditure Measure (**HEM**) benchmark does not constitute verification of a borrower's expenditure.

The report underlined reforms to home lending including the duties of mortgage brokers and associated remuneration structures. The Commission acknowledged the recent changes lenders have made to their processes and procedures for the assessment of the financial situation of loan applicants. The Commission also emphasised the main value of trail commissions to the recipient was 'money for nothing'.

The report recommended the law should be amended to provide that, when acting in connection with home lending, mortgage brokers must act in the best interests of the intended borrower and the obligation should be a civil penalty provision (R1.2). The report detailed changes to the existing remuneration arrangements for brokers (R1.3) over a two to three year period to result in the borrower, not the lender, paying the mortgage broker a fee. The Commissioner also recommended a Treasury-led working group be established to monitor and, if necessary, adjust

the remuneration model referred to in R1.3, and any fee that lenders should be required to charge to achieve a level playing field, in response to market changes (R1.4). Additionally, the Commissioner suggested following a sufficient period of transition, mortgage brokers should be subject to and regulated by the law that applies to entities providing financial product advice to retail clients (R1.5) and examined misconduct by mortgage brokers (R1.6). The Commission also stated the introducers must only act within their role's prescribed confines, entities must have systems to ensure introducers remain within these restrictions and that introducers do not modify an entities own responsible lending obligations.

The Commission strongly recommended removing the exemption of retail dealers from the operation of the NCCP Act, with the consequence that retail dealers would be subject to the requirements of that Act (R1.7) and that add-on insurance should generally be sold under a deferred sales model. The report outlined amendments to be made to the 2019 Banking Code to improve access to banking services (R1.8) and highlighted the importance of continuing to develop innovative solutions to address barriers to access, including services identified as helpful by those working with Aboriginal and Torres Strait Islander communities.

Lending to small and medium enterprise

The Commission advised the NCCP Act should not be amended to extend its operation to lending to small businesses (R1.9) however recommended the Australian Banking Association (**ABA**) should amend the definition of 'small business' in the Banking Code so that the Code applies to any business or group employing fewer than 100 full-time equivalent employees, where the loan applied for is less than \$5 million (R1.10). The Commissioner stated that he does not favour the altering or adding to the existing laws in relation to guarantees. The report also outlined reform in agricultural enterprises, including introducing a national scheme of farm debt mediation (R1.11), strengthening standards for valuations (R1.12), not charging default interest on loans secured by agricultural land in an area declared to be affected by drought or other natural disaster (R1.13) and processes banks should implement when dealing with distressed agricultural loans (R1.14)

Enforceability of industry codes

The report set out a model for enforceable code provisions (R1.15) and discussed the importance of some provisions of industry codes be applied as law, including provisions that govern the terms of the contract made or to be made between the bank and the customer or guarantor designated as 'enforceable code provisions' in the Banking Code (R1.16). The Commission addressed their recommendations in relation to consumer lending and lending to small businesses are underpinned by improving the ways in which banking products work through responsibility for product design, delivery and maintenance into the Banking Executive Accountability Regime (**BEAR**) (R1.17) and making the Banking Code more meaningful by introducing statutory consequences for breaching key provisions of the Code.

Financial Advice



Commission focussed on three main themes in relation to financial advice

The Commission made recommendations in relation to three core areas of financial advice including, 'fee for no service', inappropriate advice and an ineffective and fragmented disciplinary system.

Within these three core areas, the Commission has made a total of 10 recommendations with respect to financial advice. These are summarised below.

Fee for no service

'Fee for no service' arises where ongoing advice fees are charged when no advice was given to the client. This ongoing fee arrangement gives the adviser a financial advantage as well as an incentive to act in their own interests rather than the best interests of the client. While these issues have been exacerbated by poor record keeping, the Commission has rejected that the ongoing collection of such fees can be explained away by system errors.

The Commission has recommended that the law should be amended to require an annual renewal of any ongoing fee arrangements and for records to be kept of the services provided and fees charged which the client is entitled to receive (R2.1).

Inappropriate advice

The Commission observed that it is necessary to challenge the fundamental premise of the Future of Financial Advice legislation reforms (**FoFa** reforms) that conflicts can be 'managed'. Not all conflicts can be 'managed' and as far as possible, conflicts should be eliminated. Additionally, the Commission found a number of behaviours present in relation to the provision of inappropriate advice:

- Advisers proposed actions that benefited the adviser;
- Advisers proposed actions that benefited the licensee either with whom the adviser was aligned or by whom the adviser was employed;
- Advisers lacked skill and judgment; and
- Licensees have been unwilling to find out whether poor advice had been given and, if it had, to take timely steps to rectify it.

The behaviours are summarised below.

Conflicts of duty and interest

The Commission has found that poor advice is often given as the result of a conflict of interest. The Commission therefore recommended the law should be amended to require the express disclosure of a lack of independence where personal advice is provided to a retail client.

The Commission suggested a possible amendment of the 'best interest duty' under section 961B of the Corporations Act. However the Commission recommended no change at this time, but that a review be conducted and completed no later than 31 December 2022 by the Government in consultation with ASIC of the effectiveness of measures that have been implemented by the Government, regulators and financial services entities to improve the quality of financial advice (R2.3). This would include the removal of the 'safe harbour' provision unless clear justification for its retention is established

The Report supported the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018 (Cth) given it will promote the provision of suitable financial products to consumers and assist addressing conflicts of interest in the financial advice industry.

The Commission ruled out mandating structural separation noting that that industry is already undergoing significant change. However, the Commission supported the Productivity Commission's recommendation that commencing in 2019, the Australian Competition and Consumer Commission (ACCC) should undertake 5 yearly market studies on the effect of vertical and horizontal integration in the financial system.

Improved education and standards

The Report stressed that improved education standards and training of financial advisers will form part of the solution to improve the quality of advice given. However, without better management of conflicts of interest, poor advice will continue.

Conflicted remuneration

The Report noted that steps to reduce or eliminate conflicts of interest in the financial advice industry, must begin with an examination of the exceptions to the conflicted remuneration prohibitions under the Corporations Act and whether they are justified. As a result:

- the Commission recommended that grandfathered commissions for conflicted remuneration should be repealed as soon as reasonably practicable (R2.4).
- the Commission recommended that when ASIC conducts its review of conflicted remuneration relating to life risk insurance products and the operation of the ASIC Corporations (Life Insurance Commissions) Instrument 2017/510, ASIC should further reduce the cap on commissions and unless there is a clear justification for retaining those commissions, the cap should ultimately be reduced to zero (R2.5).
- the Commissioner further advised that the Government consider repealing the exemptions for general insurance products and consumer credit insurance products and the exemptions for non-monetary benefits set out in section 963C of the Corporations Act (R2.6 in connection with R2.3).

Ineffective and fragmented disciplinary system

The Commission has noted that financial services is an 'aspiring profession' made up of Australian Financial Services Licence (**AFSL**) holders, the Australian Securities and Investments Commission (**ASIC**), industry associations and the soon-to-be appointed code monitoring bodies for monitoring compliance with the Code of Ethics developed by Financial Adviser Standards and Ethics Authority (**FASEA**) that will come into force in January 2020.

The Report noted that while ASIC has power to ban financial advisers from providing financial services, the current disciplinary system for financial advisers is 'fragmented and ineffective', exacerbated by the inadequate sharing of information between the regulators.

In order for financial services to become a coherent system of professional discipline, the Commission calls for a new disciplinary system to be established (R2.10) and for misconduct by financial advisers to be identified and remediated (R2.9).

The following steps are suggested by the Commission:

- Each financial adviser should be individually registered.
- Only those who are registered should be permitted to give financial advice.
- There should be a single, central disciplinary body with the power to impose disciplinary sanctions on financial advisers – the most serious sanction being cancellation of registration.
- There should be a system of mandatory notifications, requiring AFSL holders to report particular information about the conduct of financial advisers to the disciplinary body.
- There should be a system of voluntary notifications, enabling AFSL holders, industry associations and clients to report information about the conduct of financial advisers to the disciplinary body.

Superannuation



Commission focussed on four main themes in relation to superannuation

The Commission made recommendations in relation to four core areas of superannuation, including Trustees' obligations, 'selling' superannuation, nominating default funds & regulation.

Within these four core areas, the Commission has made a total of 9 recommendations with respect to superannuation. These are summarised below.

Trustees' obligations to members

The report advised trustees must improve the performance of their duties and suggested restricting their role to avoid conflicts, including by precluding them from acting as dual-regulated entities and prohibiting them from the 'treating' of employers (R3.6). The Commission recommended the trustee of a registrable superannuation entity (RSE) should be prohibited from assuming any obligations other than those arising from or in the course of its performance of the duties of a trustee of a superannuation fund (R3.1).

The report recognised that evidence showed recurring issues and difficulties to which trustees and the regulators need to give close and continuing attention and observed disclosure of conflicts of interests on its own is not enough, the instigation and maintenance of every arrangement about administration and investment, must be judged against the best interests of members and regulators must be astute to observe whether trustees are giving priority to the interests of members.

The Commissioner suggested focussing on the existing requirements rather than introducing a new layer of regulation and considered that using superannuation money to pay for such broad financial advice is not consistent with the sole purpose test. The report recommended deduction of any advice fee (other than for intra-fund advice) from a MySuper account should be prohibited (R3.2). The report also outlined tightly controlled ways of operation if ongoing advice fees continued to be permitted, as two years without confirmation that the member wishes the arrangement to continue is too long and recommended limitations on deducting advice fees from choice accounts (R3.3). The Commission examined paying grandfathered commissions and concluded to cease the grandfathering arrangements made at the time of the Future of Financial Advice (FoFA) reforms as the "time for transition has passed".

The report explored board composition and mergers upon discussing governance in superannuation with the overarching objective being the best interests of members.

'Selling' superannuation and default funds

The report identified all forms of unsolicited offering of superannuation arrangements should be prohibited (R3.4) however, the prohibition should not prevent trustee or related entities advertising generally the availability of the fund. The report also recommended that a person should have only one default account and that to that end, machinery should be developed for 'stapling' a person to a single default account (R3.5).

Regarding issues around accessibility, the report noted that there is no reason for any entity not to have practices and procedures outlined by the Australian Transaction Reports and Analysis Centre (**AUSTRAC**) which follow particular identification and verification procedures for Aboriginal and Torres Strait Islander peoples and there is no reason for any entity not to have trained staff to use them. The Commission also urged for consultation with relevant Aboriginal and Torres Strait Islander peoples to discuss difficulties about binding death benefit nominations that should be met.

Regulatory framework

The report examined the regulatory framework, drawing the distinction that unlike other financial products, superannuation must extend to the 'outcomes' that will be delivered to members. When assessing regulation and enforcement the report recommended that breach of the trustee's covenants set out in section 52 or obligations set out in section 29VN, or the director's covenants set out in section 52A or obligations set out in section 29VO of the Superannuation Industry (Supervision) Act 1993 (Cth) (the SIS Act) SIS Act should be enforceable by action for civil penalty (R3.7). The Commission also rejected the creation of a superannuation-only regulator and advised the twin peaks model of regulation should be maintained however the roles and powers of APRA and ASIC should be adjusted to enable better supervision of superannuation entities and more effective enforcement of the duties owed by trustees and by directors of trustees (R3.8). The report recommended that over time, provisions modelled on the BEAR should be extended to all RSE licensees (R3.9) citing the advantage of this course of action was that the imposition of the obligations clarifies what is expected of the relevant senior executives.

Insurance



Commission focussed on five main themes in relation to insurance

The Commission made recommendations in relation to five core areas of insurance, including selling practices, pre-contractual disclosure, the handling of claims, industry codes and group life insurance.

Within these five core areas, the Commission made a total of 15 recommendations with respect to insurance. These are summarised below.

Selling practices

Consistent with Recommendation 3.4 (prohibiting the hawking of superannuation products), the Commission recommended that unsolicited offers or sales, or hawking, of insurance products be banned (R4.1). In making this recommendation, the Commission referred to ASIC Report 587: *The Sale of Direct Life Insurance (Report 587)*, which detailed that all of the six insurers and three distributors examined engaged in detrimental pressure selling to customers, which involved sales calls that included 'inadequate explanations of future cost and product exclusions, [offers of] promotional gifts, and tactics to reduce informed decision-making.¹

To ensure that the proposed prohibition on the hawking of insurance products is effective, the Commission noted that a statutory definition should be implemented to define what is 'unsolicited'. The Commission suggested that the definition currently used by ASIC – that something is unsolicited 'unless it takes place in response to a positive, clear and informed request from a consumer' – would be useful in this regard.

The Commission noted that additional steps should be taken with respect to each of funeral insurance and add-on insurance. The Commission recommended that the law be amended to 'remove the exclusion of funeral expenses policies from the definition of 'financial product' and 'put beyond doubt that the consumer protection provisions of the Australian Securities and Investments Commission Act 2001 (Cth) (the ASIC Act) apply to funeral expenses policies' (R4.2). With respect to add-on insurance, the Commission recommended that an industry-wide deferred sales model for the sale of any add-on insurance products (except policies of comprehensive motor insurance) should be developed by a Treasury-led working group as soon as possible (R4.3). Additionally, the Commission

recommended that ASIC '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' (R4.4).

Pre-contractual disclosure

The Commission noted that amendments made to Part IV of the Insurance Contracts Act 1984 (Cth) (the Insurance Contracts Act) in 2013 expanded the circumstances in which an insurer can avoid a contract of life insurance. Significantly, the Commission recommended that the previous provision that existed prior to the amendments be restored, to 'replace the duty of disclosure with a duty to take reasonable care not to make a misrepresentation to an insurer' (together with any consequential amendments) (R4.5). Further, the Commission recommended that section 29(3) of the Insurance Contracts Act be amended 'so that an insurer may only avoid a contract of life insurance if it can show that it would not have entered into a contract on any terms' (R4.6). The Commission noted that this change is supported by numerous consumer organisations and the Financial Services Council.

Claims handling

Regulation 7.1.33 of the *Corporations Regulations 2001* (Cth) (the **Corporations Regulations**) carves out the handling and settlement of insurance claims from the definition of 'financial service'. The Commission highlighted that this means that some of the obligations set out in section 912A of the Corporations Act – including the obligation to do all things necessary to ensure that financial services are provided efficiently, honestly and fairly – does not govern the way in which insurers handle or settle claims. The Commission recommended that the Corporations Regulations be amended so that the handling and settlement of insurance claims, or potential insurance claims, is no longer excluded from the definition of 'financial service' (R4.8).

¹ ASIC, Report 587, 30 August 2018, 7 [20].

Industry codes

The Commission recommended that the law be amended to provide for enforceable provisions of industry codes and the establishment and imposition of mandatory industry codes – including making certain provisions of existing codes (such as the Life Insurance Code of Practice, the Insurance in Superannuation Voluntary Code and the General Insurance Code of Practice) ‘enforceable code provisions’, a breach of which will constitute a breach of the law (R4.9).

Group Life Insurance

The Commission noted that ‘an important feature of the life insurance market’ is that life cover, income protection cover, trauma cover and total and permanent disability cover are also available through group insurance structures, such as within superannuation funds. Notably, the Commission highlighted the findings of the Productivity Commission’s Draft Report, which stated that ‘about a quarter of superannuation fund members do not know whether they have a policy’.²

To address issues identified in the MySuper group life policies, the Commission recommended that Treasury, in consultation with industry, should ‘determine the practicability, and likely pricing effects, of legislating key definitions, terms and exclusions for default MySuper group life policies’ (R4.13).

Further, the Commission sought to address issues that arise with respect to Registrable Superannuation Entity (RSE) licensees that engage a related party to provide group life insurance, or who enter into a contract arrangement or understanding with a life insurer by which the insurer is given a priority or privilege in connection with the provision of life insurance. The Commission recommended that those RSE licensees:

- be required to provide APRA within a fixed time ‘independent certification that the arrangements and policies entered into are in the best interests of members and otherwise satisfy legal and regulatory requirements’ (R4.14); and
- be required to ‘be satisfied that the rules by which a particular status is attributed to a member in connection with insurance are fair and reasonable’ (R4.15).

² Productivity Commission, Report 91, *Superannuation: Assessing Efficiency and Competitiveness*, 21 December 2018, 365.

Culture, Governance & Remuneration



Commission focussed on three main themes in relation to culture, governance and remuneration

The Commission made recommendations in relation to three core areas of remuneration, culture and governance.

Within these three core areas, the Commission made a total of 7 recommendations. These are summarised below.

Culture, Governance and Remuneration

Culture, governance and remuneration are key themes arising from the report. The Commission makes it clear that the primary responsibility of misconduct in the financial service industry lies with the entities concerned, their boards and their senior management.

The Commission noted that each entity must give close attention to the connections between compensation, incentive and remuneration practices and consider how it manages regulatory, compliance and conduct risks.

Remuneration

The Commission noted that remuneration and incentives (especially when variable) communicate to staff what behaviour is rewarded, therefore linking remuneration and misconduct.

The Commission recommended that the APRA revise its prudential standards and guidance regarding remuneration as expeditiously as possible (R5.1, R5.2 and R5.3). Further to this, APRA (and ASIC where appropriate), should do more to gather information about the way remuneration systems are being applied in practice, and whether those systems are encouraging sound management of non-financial risks, and reducing the risk of misconduct.

The Commission noted three issues in connection with implementing remuneration:

- risk-related adjustments to remuneration;
- supervision of the implementation of remuneration arrangements; and
- disclosure of the fact of, or reasons for, risk-related adjustments to remuneration.

The Commission noted that the reduction of the variable remuneration of executives for poor management of non-financial risks communicates a strong message to staff about what kind of conduct the board regards as unacceptable.

However the Commission conceded that banks have recently made, and are continuing to make, significant changes to the way in which they remunerate their front line staff, and recommended that all financial services entities should review the design and implementation of their remuneration systems for front line staff to focus on not only *what* staff do, but also *how* they do it (R5.4).

The Commission noted that in 2016, the ABA launched its 'Banking Reform Program'. As part of that program, the ABA appointed Mr Stephen Sedgwick AO to conduct an independent review into remuneration practices in retail banking. The Commission recommended the full implementation 'both in letter and in spirit' of the 21 Sedgwick recommendations as an important first step towards improving front line remuneration practices (R5.5).

Culture

Described in the report as the 'shared values and norms that shape behaviours and mindsets' within the entity³ and 'what people do when no-one is watching'⁴, culture can drive or discourage misconduct and the tone set by leadership matters.

The Commission noted that each entities culture is different and there is no single 'best practice' however there are basic behavioural norms that should be adhered to including:

- obey the law;
- do not mislead or deceive;
- act fairly;
- provide services that are fit for purpose;
- deliver services with reasonable care and skill; and
- when acting for another, act in the best interests of that other.

The Commission recognised that culture cannot be prescribed or legislated but it can, and must, be assessed. Entities must identify, assess, develop and improve problematic aspects of their culture (R5.6), and where entities are not able to do this effectively, regulators should:

- assess the entity's culture;
- identify what is wrong with the culture;
- 'hold up a mirror' to the entity,⁵ and educate the entity about its own culture;
- agree what the entity will do to change its culture; and
- supervise the implementation of those steps (However, the Commission also noted that APRA requires the resources necessary to conduct proper prudential supervision).

The Commission recommended that APRA should build the supervision of culture and governance into the review of its prudential standards and guidance (R5.7).

Governance

The Commission stated that governance shapes how the business is run and shapes its culture. Therefore, poor leadership will undermine the governance framework. The Commission recognised that the failings in governance and the occurrence of misconduct falls into three categories: the role of the board, the entity's priorities and accountability.

The Commission further noted that boards cannot operate without the right information and if they do not challenge management on issues such as breaches of the law and standards of conduct.

Proper governance requires setting priorities which may mean the choice between conflicting goals or courses of action.

Further to this, the Commission reiterated that directors must exercise their powers and discharge their duties in good faith in the best interests of the corporation, and for a proper purpose.⁶ This reinforces that it is the corporation (and not the shareholders) that must be the key focus of their duties.

The Commission stressed the equal importance of non-financial risks including compliance risk, conduct risk, regulatory risk and operational risk as the types of risk associated with misconduct and more difficult to measure than financial risk.

While not expressly recommended, the Commission stated APRA should give consideration to how the management of non-financial risk can be made more prominent in its prudential standards.

³ Cf CBA Prudential Inquiry, Final Report, 81. the Commission deliberately omit reference to a 'system' of shared values and norms if only to emphasise that culture is observed and described, not created apart from, or imposed on, the entity.

⁴ G30, *Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform*, July 2015, 17.

⁵ Exhibit 7.152, April 2018, Refocusing Risk Culture Pilot Reviews, 3.

⁶ Corporations Act s 181(1). See also the 'business judgment rule' in s 180(2), which depends, among other things, on the director or other officer rationally believing that the judgment made 'is in the best interests of the corporation'.

Accountability

The Commissioner stressed that accountability is vital to effective governance. Accountability fosters a culture where risks are managed soundly and ensures the proper operation of any variable remuneration and incentive system. A lack of accountability contributes to 'an inability to identify who is accountable when things have gone wrong; inadequate remuneration outcomes for adverse risk and compliance outcomes; weak issue escalation, management and closure; insufficient Executive Committee oversight; and inadequate business unit supervision.'⁷

The BEAR

The Commission confirmed that APRA should determine under section 37BA(4) of the Banking Act 1959 (Cth), an additional responsibility of accountable persons within each of the banks subject to **BEAR**. That additional responsibility would be for the end-to-end management of product design, delivery, maintenance and, where necessary, remediation. The Commission stated that it would then be for each bank to identify the relevant accountable person.

⁷ CBA Prudential Inquiry, Final Report, 59.

Regulators



Commission focussed on seven main themes in relation to Regulators

The Commission made recommendations in relation to seven core areas, including twin peaks, ASIC's enforcement practices, superannuation conduct regulation, BEAR, information sharing, governance and oversight.

Within these seven core areas, the Commission made a total of 14 recommendations with respect to insurance. These are summarised below.

ASIC remit and changing ASIC enforcement culture

The Commission was not persuaded that the two principles underpinning the twin peaks model of financial regulation should now be abandoned or should be given substantially different effect by dividing ASIC's regulatory role, and that the 'twin peaks' model of financial regulation should be retained (R6.1). The report investigated changing ASIC's enforcement culture, listed reasons for caution and recommended an approach to their enforcement practices (R6.2). The report detailed for ASIC to approach breaches with the question "why not litigate?" and that ASIC must exercise skill and judgement, especially when the issue appears systemic. The Commission emphasised ASIC will require clarity in the work ahead of what kinds of outcome are being considered. Furthermore, if it is not in public interest to pursue litigation then ASIC is to actively consider all forms of regulatory action, the Commission suggested a close monitoring of ASIC's progress in reforming its enforcement function.

The report recognised litigation is to be considered as a "public power for public purposes" and that the starting point for consideration should be the law is to be obeyed and enforced and deterring misconduct is dependent on visible public denunciation and punishment. The Commission also concluded infringement notices give the regulator a course of action which is unlikely to have any real deterrent effect and their use beyond regulatory matters is rarely appropriate. The report also examined enforceable undertakings and the separation between enforcement staff from non-enforcement related contact with regulated entities.

Co-regulation by APRA and ASIC

The Commission suggested the twin peaks should be reinforced in superannuation and recommended that APRA's remit in respect of the SIS Act be shared with ASIC in a way that aligns with their traditional roles and strengths. The report details that by providing ASIC with power to protect the interests of members would provide some consistency across the two legislative regimes that apply to RSE licensees and that ASIC's approach to its core tasks is consistent with the deterrence of misconduct objective. The report recommended general principles for co-regulation in superannuation (R6.3) outlining the adjusted roles of APRA and ASIC and confirming that the provisions should not exclude APRA from exercising the same powers. The Commission outlined the roles in their recommendation as ASIC as a conduct regulator (R6.4), APRA to retain functions (R6.5), the joint administration of BEAR (R6.6) with a division of overseeing parts, statutory amendments (R6.7) to make clear that an ADI and accountable person must deal with APRA/ASIC in an open, constructive and co-operative way and extending BEAR (R6.8) that over time provisions modelled on BEAR should be extended to all APRA-regulated financial services institutions.

Information sharing

The Commission noted that, of ASIC and APRA's various memoranda of understanding with each other and other regulators, many use 'permissive' or 'aspirational' language rather than any commitment to specific obligations. This has resulted in an inability of the regulators to appropriately share relevant information, and has further resulted in regulators often acting without all of the information that is available. The Commission recommended that the law be amended to oblige each of APRA and ASIC to 'co-operate with the other, share information to the maximum extent practicable and notify the other whenever it forms the belief that a breach in respect of which the other has enforcement responsibility may have occurred (R6.9).

Additionally, the Commission recommended that ASIC and APRA prepare and maintain 'a joint memorandum setting out how they intend to comply with their statutory obligation to co-operate'. The Commission recommended that the memorandum 'be reviewed biennially and each of ASIC and APRA should report each year on the operation of and steps taken under it in its annual report' (R6.10).

Governance of the regulators

The Commission noted that it was required to inquire into and report on 'the effectiveness and ability of regulators of financial services entities to identify and address misconduct by those entities'. The Commission noted that this point of inquiry relates to the internal governance and accountability of both ASIC and APRA.

Although not an explicit recommendation, the Commission commented that it was of the view that APRA could benefit from the appointment of 'one or two' new non-executive directors. The Commission's specific recommendations as to ASIC and APRA's governance and accountability are outlined below.

Meeting procedures

With respect to meeting procedures, the Commission recommended that the ASIC Act be amended to 'include provisions substantially similar to those set out in sections 27-32 of the Australian Prudential Regulation Authority Act 1998 (Cth) (the APRA Act) – dealing with the times and places of Commissioner meetings, the quorum required, who is to preside, how voting is to occur and the passing of resolutions without meetings' (R6.11). The Commission noted that whilst the APRA Act contains provisions dealing with the times and places of meetings and the quorum required, there were no analogous provisions in the ASIC Act.

Application of the BEAR

The Commission recommended that, 'in a manner agreed with the external oversight body (the establishment of which is the subject of Recommendation 6.14) each of APRA and ASIC should internally formulate and apply to its own management accountability principles of the kind established by BEAR. (R6.12). The Commission noted that through implementing the BEAR, each of the regulators would be required to consider its internal arrangements carefully by way of the accountability maps and statements that BEAR requires.

Periodic capability reviews

The Commission noted that whilst ASIC has recently undergone a capability review, APRA has not. In this regard, the Commission recommended that APRA and ASIC should each be subject to at least quadrennial capability reviews. Further, the Commission recommended that APRA undertakes a capability review as soon as possible (R6.13).

A new oversight authority

The Commission made a recommendation with respect to the establishment of a new oversight body for APRA and ASIC, being a body that is independent of government, established by legislation to 'assess the effectiveness of each regulator in discharging its functions and meeting its statutory obligations'. In its recommendation, the Commission noted that the authority should comprise three part-time members, and should also be staffed by a permanent secretariat. The Commission recommended that the oversight body be required to report to the Minister in respect of each regulator at least biennially (R6.14).

The Commission commented on the role of the new oversight body, and noted that it would be charged with the following responsibilities (among others):

- review each regulator's compliance with the proposed statutory obligation to co-operate with each other, including fulfilling its information-sharing obligations;
- consider the extent to which each regulator has complied with the terms of the memorandum between ASIC and APRA and the effectiveness of the operation of the memorandum;
- assess ASIC and APRA's adoption of BEAR (in this regard, the oversight entity should have a told broadly analogous to that of APRA under the current BEAR regime).

Other Important Steps



Commission outlines important next steps

The Commission provided recommendations as to those issues already considered and dealt with by other processes, but not implemented pending the outcome of the Royal Commission's inquiry.

Chapter 8, Volume 1 of the Royal Commission's Final Report steps through those recommendations that relate to issues already considered and dealt with by other processes (i.e. outside of the Royal Commission's inquiries), but that are awaiting implementation subject to the outcome of the Commission's findings. Those include the proposed compensation scheme of last resort, the Government's Response to ASIC's Enforcement Review Taskforce and simplification of the law so that its intention is met. These are outlined in further detail below.

Compensation scheme of last resort

In the Commission's Interim Report, the Commission asked whether the dispute resolution mechanisms that currently exist were satisfactory, and whether a mechanism should be established to provide compensation of last resort.⁸

The Commission noted that a panel appointed by the Government in 2016-2017 provided a report in April 2017 regarding its findings in relation to its review of external dispute resolution and complaints arrangements in the financial system. This included recommendations from the panel on the establishment and structure of a compensation scheme of last resort (**CSLR**), as well as consideration as to whether such a scheme had merit.

The Commission noted that the panel's supplementary final report included three recommendations for a CSLR, being:

- 'A CSLR should be established, but should be limited and carefully targeted at the areas of the financial sector where there is clear evidence of recurrent problems with uncompensated losses'.⁹
- 'A CSLR should initially be restricted to financial advice failures where a financial adviser (the 'relevant provider' as defined in section 910A of the *Corporations Act* has provided personal and/or general advice on 'relevant financial products' to a consumer or small business. A CSLR should be designed for the future and accordingly be scalable, which means it can be expanded over time to cover other types of financial and credit services, should evidence of significant problems of uncompensated losses emerge'.¹⁰
- A number of recommendations as to the specific design features of the proposed CSLR.

The Commission agreed with the approach proposed by the panel in relation to the CSLR, and recommended that the three recommendations to establish a CSLR made by the panel be carried into effect (R7.1).

⁸ Financial Services Royal Commission, *Interim Report*, vol 1, 344.

⁹ Ramsay Review, Supplementary Final Report, 51, Recommendation 1.

¹⁰ Ramsay Review, Supplementary Final Report, 67, Recommendation 2.

ASIC Enforcement Review Taskforce Government Response

The Commission noted that the ASIC Enforcement Review Taskforce's (**Taskforce**) report, issued to the Government in December 2017, made 50 recommendations. In particular, the Commission noted that it supports the Taskforce's recommendations with respect to self-reporting of contraventions by financial services and credit licensees. The Commission recommended that the recommendations made by the Taskforce in December 2017 that relate to self-reporting of contraventions by financial services and credit licensees should be carried into effect (R7.2).

In addition, the Commission expressed its view that it would be preferable for ASIC publish breach report data annually not only aggregated by breach type but also by individual licensee.

Simplification of the law

The Commission emphasised that 'the first way to simplify the law, and the first reason for doing it, is to reduce the number of exceptions to otherwise generally applicable norms of conduct'. The Commission noted that doing so would produce positive results, by expanding the application of the intention and principles that underpin the

general rules upon which those exceptions were developed. On this basis, the Commission recommended that, 'as far as possible, exceptions and qualifications to generally applicable norms of conduct in legislation governing financial services entities should be eliminated' (R7.3).

The Commission suggested that the first step to simplify the law will be to settle upon the underlying intention and principles to which the law is to give effect. The Commission suggested that any specific provisions should be drafted based on that underlying principle or intention. The Commission noted that such an approach should ensure that entities meet the intent of the law, rather than meeting the terms in which it is expressed (and often completing a simple 'box ticking' exercise). In this respect, the Commission's specific recommendation was that, 'as far as possible, legislation governing financial services entities should identify expressly what fundamental norms of behaviour are being pursued when particular and detailed rules are made about a particular subject matter' (R7.4).

The Commission noted that these recommendations, whilst important, are only a small piece in a significantly larger task which must be undertaken. However, the Commission emphasised that its recommendations should be implemented as soon as possible, and 'cannot wait for that larger task to begin, let alone end'.

Hear more from KPMG

For those with questions on the Final Report, or the Royal Commission more generally, please do not hesitate to contact a member of our team. For those interested in obtaining a full copy of the Final Report, it can be accessed [here](https://financialservices.royalcommission.gov.au):
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