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The Banking Royal Commission 12 months on....

What's changed?

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Final Report

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



This presentation will:

1

Give an overview of the Final Report of the Banking Royal Commission (**BRC**)

2

Summarise industry specific recommendations and change progress

3

Look at key changes to the regulatory landscape and what's next



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Part 1: BRC Final Report Overview

4 Key Observations from the BRC



The connection between conduct and reward



Imbalance of power and information between financial services entities and their customers



The effect of conflicts between duty and interest

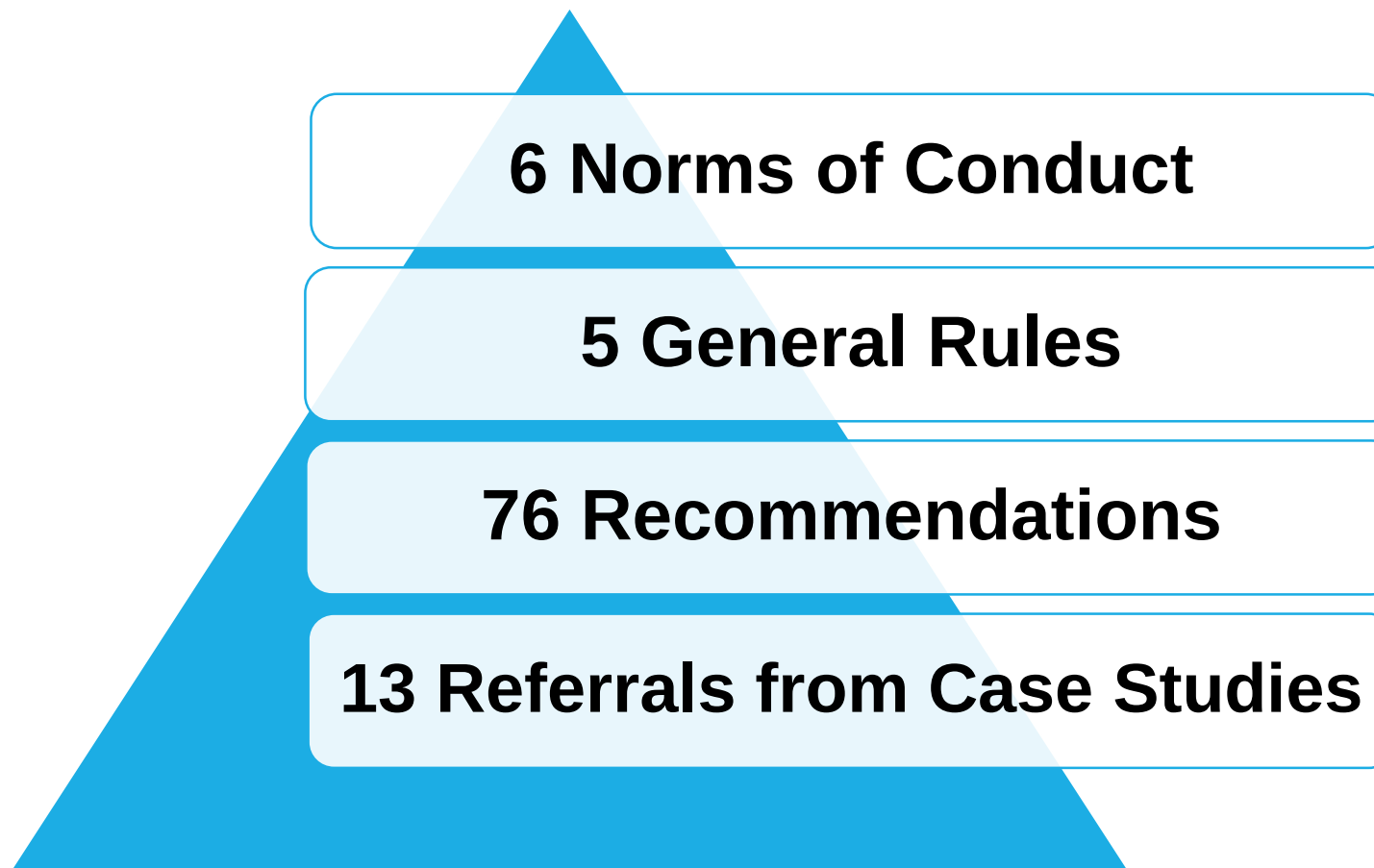
“Self-interest trumped duty”



The failure to hold entities to account for misconduct



Findings in Final Report



6 Norms of Conduct



Obey the law



Do not mislead or deceive



Act fairly



Provide services that are fit for purpose



Deliver services with reasonable care and skill



When acting for another, act in the best interest of that other

6 General Rules



The law must be applied and enforced



Industry codes should be approved under statute *“breach of key promises is a breach of the statute”*



No financial products should be hawked to retail clients



Intermediaries should act in the interests of the party who pays the intermediary



Exceptions to the ban on conflicted remuneration should be eliminated



Culture and governance practices (including remuneration) must focus on non-financial risk, not just financial performance.



Recommendations

76

54 require government action

12 were directed to regulators

10 were directed to financial services providers



Limited Additional Regulation

- Commissioner Hayne did not recommend additional regulation
- In his interim report, Commission Hayne said:
“The law already requires entities to ‘do all things necessary to ensure’ that the services they are licensed to provide are provided ‘efficiently, honestly and fairly’. Much more often than not, the conduct now condemned was contrary to law. Passing some new law to say, again, ‘Do not do that’, would add an extra layer of legal complexity to an already complex regulatory regime. What would that gain?”
- Existing law is generally sufficient, but should be simplified and enforced
- Eliminate as far as possible exceptions and qualifications to general norms in legislation norms of behaviour are being pursued
- Legislation should identify the fundamental norms of behaviour
- Many of the reforms recommended by Commissioner Hayne were already in the pipeline prior to the Royal Commission’s final report



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Part 2: Industry specific recommendations and change progress



Mortgage Brokers

A best interests duty for mortgage brokers	Legislation introduced. Proposed commencement date 1 July 2020
Regulation of mortgage brokers in the same manner as financial product advisers	Gov. accepted but not progressed until after review of financial advice reforms scheduled for 2022
Borrowers rather than lenders should pay mortgage brokers	Not accepted by Gov. Brokers allowed to keep commissions for at least 3 years but restrictions apply. No volume based commissions
Lenders should conduct reference checks, share information and report compliance concerns to ASIC	Legislation to be introduced by 30 June 2020



Consumer and SMB lending

<p>Point of sale exemption to be abolished (POS exemption means a person who arranges finance for a lender, such as a car dealer or in-store credit, doesn't have to have an Australian Credit Licence or be appointed as the lender's credit representative)</p>	<p>Legislation to be introduced by 30 June 2020</p>
<p>Australian Bankers Association (ABA) to amend Banking Code to increase access to banking services in remote and regional areas, not allow informal overdrafts or charge dishonour fees for basic accounts</p>	<p>Banking Code revised to address this recommendation, and approved by the ACCC (in November 2019) and ASIC (in December 2019). Revised Code commences on 1 March 2020</p>
<p>ABA should amend definition of "small business" in Banking Code to an entity that employs fewer than 100 FTE employees and the loan applied for is less than \$5 million</p>	<p>Gov. noted the view of the Council of Financial Regulators to maintain the current definition of small business in the Banking Code (annual turnover less than \$10 mil, fewer than 100 employees, less than \$3mil total debt). An independent review to be conducted in 2021</p>



Farm Lending

National scheme of farm debt mediation should be enacted	Gov. met with States on 9 February 2019
APRA to amend APS 220 to provide special provisions for valuing agricultural land	Amended APS 220 comes into effect 1 January 2021. It requires independent valuation of collateral, which must take into account the time taken for realisation of collateral and, to the extent possible, the likelihood of external events such as drought and flood
ABA should amend Banking Code so that banks don't charge default interest on loans secured by farms in drought or natural disaster declared areas for the duration of the declaration	Banking Code has been revised to address this recommendation, and approved by the ACCC and ASIC. Revised Code commences 1 March 2020
Changes to the way banks deal with distressed agricultural loans (managing loans by experienced agricultural bankers, early mediation, operate on the basis that workout is the best outcome and cease charging default interest when there is no prospect of recovering it)	Gov expects banks to implement ASAP



Financial Advisers

All ongoing fee arrangements must be renewed once a year by the client	Legislation to be introduced by 30 June 2020
Financial advisers must disclose lack of independence	Legislation to be introduced by 30 June 2020
Review of the effectiveness of measures taken to improve financial advice, To include if safe harbour applying to the “best interests” obligation should remain and review of commissions for general and consumer credit insurance	Gov, will conduct this review in 2022
Grandfathered commissions to be repealed as a priority	Legislation passed 28 Oct 2019. Removes grandfathering arrangement for conflicted remuneration from 1 January 2021
ASIC to conduct review of conflicted remuneration on life risk insurance products. BRC recommends ASIC examine level of cap on life insurance commissions and recommends should be ultimately reduced to zero	ASIC will conduct this review in 2021



Financial Advisers (cont.)

Licence condition requiring reference checking and information sharing protocols for financial advisers	Legislation to be introduced by 30 June 2020
Licence condition requiring reporting of serious compliance concerns about individual financial advisers to ASIC on a quarterly basis	Legislation to be introduced by 30 June 2020
Licence condition that AFSL holder who detects a financial adviser has engaged in misconduct in giving advice to a retail client must determine the full extent of the misconduct, tell the affected clients and remediate those clients immediately	Legislation to be introduced by 30 June 2020
Advisers who provide personal advice to retail clients should be subject to central disciplinary body	Establishment of a new disciplinary system and single disciplinary body for financial advisers. ASIC-enforced Code of Ethics will apply from 1 January 2020 and a new single disciplinary body will be established by early 2021



Superannuation

Super trustees not to have any obligations other than those related to being the trustee of the fund	Legislation introduced by 30 June 2020
Deduction of advice fees from a MySuper account banned	Legislation introduced by 30 June 2020
Deduction of advice from choice accounts only if all the requirements about annual renewal, prior written identification of service and express written authority is complied with	Legislation introduced by 30 June 2020
Hawking of super products should be banned	Legislation introduced by 30 June 2020



Insurance

Hawking of insurance products to be banned.	Legislation to be introduced by 30 June 2020. On 4 December 2019 ASIC announced a ban on unsolicited 'cold call' telephone sales of direct life insurance and consumer credit insurance (CCI), taking effect on 13 January 2020.
Exemption for sale of funeral insurance should be removed.	Legislation introduced Nov 19
Develop industry-wide deferred sales model for any add-on insurance products to be implemented as soon as practicable.	Consultation Paper issued Sept 2019 for introduction of an industry-wide deferred sales model for "add-on" insurance, such as travel insurance and consumer credit insurance. A four day deferral period is proposed. In Oct 2019, ASIC released consultation paper on proposals to use its product intervention power to reform the sale of add-on financial products (including insurance products) by car dealers.



Insurance (cont.)

Cap to be imposed on the amount of commission that can be paid to car dealers for the sale of add-on insurance	Legislation to be introduced by 30 June 2020
Unfair contract terms should apply to insurance contracts	Legislation introduced and if passed, will come into effect on 5 April 2021
The handling and settlement of insurance claims should be a financial service	Treasury has released for consultation exposure draft legislation



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Part 3: Key changes and looking forward



Key Changes to Regulatory Landscape



Regulator Enforcement (including new higher penalties and new offences)



Culture and Governance



Remuneration and Incentives



Individual Accountability



Consumers Dispute Resolution and Remediation



Enforceable Industry Codes



Regulator Enforcement

Twin peaks model retained	The Government has committed to retaining the twin peaks model of financial regulation. APRA to retain prudential supervision but greater focus on non-financial risk. ASIC remains conduct regulator
ASIC adopt “why not litigate?” policy	Office of Enforcement established in ASIC to strengthen ASIC’s enforcement culture and effectiveness and implement a single enforcement strategy for ASIC. Will lead the application of ASIC’s ‘why not litigate’ approach
ASIC should use infringement notices for administrative failing and rarely as enforcement tool for large companies	In 2019 ASIC commenced a number of legal proceedings against financial firms for alleged breaches of laws it administers



Regulator Enforcement (cont.)

ASIC to be given power to enforce SIS Act civil penalty provisions	ASIC to take a greater role in the regulation of super trustees. Legislation to be introduced by 30 June 2020
ASIC and APRA to jointly administer BEAR	Legislation to be introduced by the end of 2020
Regular capability reviews of regulators	Gov. committed to regular reviews. APRA Capability Review in March 2019. Gov. agreed to take action on all 5 of the recommendations directed to it and APRA indicated support for all 19 of the recommendations directed to it
New oversight authority to assess effectiveness of each regulator	Legislation to be introduced by 30 June 2020
Statutory obligation to co-operate, and a co-operation memorandum	ASIC and APRA updated MOU in November 2019. Legislation for the obligation to co-operate will be introduced by 30 June 2020



Increased Penalties for Misconduct and New Civil Penalty Provisions

- New legislation in February 2019 – most provisions commenced March-April 2019.
- **Criminal offences:**
 - Prison terms for most serious offences in Corporations Act (e.g. intentionally contravening director duties, or dishonest failure to comply with financial and audit obligations) increasing from 5 to 15 years.
 - Financial penalties increased –
 - if fine is the only penalty specified, multiply 10 times for a company;
 - if penalty is for a term of imprisonment of 15 years or more, financial penalty is increasing to the greater of:
 - for companies: 45,000 penalty units (\$9.45 million); 3 times the benefit gained or loss avoided; or up to 10 per cent of annual turnover; and
 - for individuals: 4,500 penalty units (\$945,000); or 3 times the benefit gained or loss avoided.
 - if penalty is a term of imprisonment of less than 15 years, financial penalty is calculated by multiplying the prison term (in months) by:
 - 100 penalty units for a corporation; and
 - 10 penalty units for an individual.



Increased Penalties for Misconduct and New Civil Penalty Provisions (cont.)

- **Civil contraventions:** penalties increasing – e.g. for a company, from \$1 million to the greater of 50,000 penalty units (\$10.5m), 3 x benefit gained or loss avoided, or 10% of annual turnover (capped at 2.5m penalty units or \$525 million).
- **Extension of civil penalty regime:** New penalties include:
 - failing to report a breach within 10 day timeframe; and
 - a breach of s 912A obligation for an AFS licensee to do “all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly”.
- **New criminal offences:** e.g. a new offence of failure to keep financial records, where there is a criminal intent (in addition to existing offence where intent does not have to be proved).
- **New definition of dishonesty:** “dishonest according to the standards of ordinary people”. Relevant to offences which involve dishonest conduct.
- Section 184(1) of the Corporations Law has been amended to remove the word “intentional”



Additional Tools for Regulators

- Draft legislation introduced November 2019 to implement some ASIC Enforcement Review Taskforce recommendations.
 - **licensing powers:** replacing the AFS Licence requirement that a person be of 'good fame and character' with an on-going requirement that they be a 'fit and proper person'
 - **banning powers:** ASIC can ban a person from controlling or performing any functions in a financial services or credit business (previously just providing financial services) and ASIC can take account of a broader range of matters (e.g. culture of non-compliance and management of a financial services or credit business) when deciding to ban
 - **search warrants and interception:** harmonises ASIC's search warrant powers and allows interception agencies to give information to ASIC for investigating or prosecuting serious offences



Additional Tools for Regulators (cont.)

- April 2019 – legislation introduces a **product intervention power (PIP)** for ASIC
- Product intervention power:
 - a proactive power for ASIC to intervene when a product has resulted, will result or is likely to result in significant detriment to consumers – even if no breach of law
 - can be an individual product intervention order, which applies to specified person(s), in relation to a product or a market-wide product intervention order
 - order can be for an initial period of up to 18 months; can be extended or made permanent if Minister approves
 - requirements around consultation and the release of a statement by ASIC setting out why the order is appropriate
- ASIC has already exercised its product intervention powers in several instances (e.g. banning a certain short-term lending model).



Referrals to ASIC/APRA

- 13 referrals by the Royal Commission
- 17 case studies under review
- Proceedings launched so far –
 - NAB – Introducer Program
 - Select – telephone sales of insurance
 - NAB – fees for no service
 - TAL – income protection claim handling
 - Dover – Client Protection Policy misleading and deceptive
- Expect others will be launched in the near future
- Much of the conduct occurred before the increases in penalties



Regulators 2020:

- Increased Litigation/ limited settlements
- Case study referrals to be litigated
- Conduct after 13 March 2019 now under increased penalties and new provisions
 - First cases for breach reporting and “efficient, honest and fair”
- “Close supervision”
- APRA gets “constructively tough”
- Targeting individuals
- “Stepping stone” liability for directors (Vocation case)
- APRA on conduct and non-financial supervision (conduct, governance, risk)
- Dual regulation role on superannuation
- Regulators subject to BEAR like accountability (REAR)



Culture and Governance

All financial services entities should take steps to:

- **Assess culture and governance**
- **Identify problems**
- **Deal with problems**
- **Determine whether changes have been effective**

Gov. expects all financial services entities to monitor culture and governance on an ongoing basis.

ASIC established a Corporate Governance Taskforce in 2018. First report in October 2019, examining oversight and management of non-financial risk.

The Taskforce will report soon on its review of executive remuneration practices in 21 of the ASX 100 companies.



Culture and Governance (cont.)

APRA should:

- **Build supervisory program focusing on building culture that will mitigate risk of misconduct;**
- **Use a risk-based approach to its reviews;**
- **Assess the cultural drivers of misconduct in entities; and**
- **Encourage entities to give proper attention to sound management of conduct risk and improving entity governance.**

APRA issued updated Prudential Standard *CPS 510 Governance* effective 1 July 2019. It sets out minimum foundations for good governance of an APRA-regulated institution.

On 19 November 2019, APRA released an information paper *Transforming governance, culture, remuneration and accountability: APRA's approach*. APRA has committed to strengthening and intensifying its approach to overseeing governance, culture, remuneration and accountability (GCRA).



APRA self-assessments

- APRA report analysing the self-assessment of 36 banks, insurers and superannuation licensees
- Weaknesses found in CBA inquiry not unique to CBA
- Common themes:
 - non-financial risk management requires improvement;
 - accountabilities are not always clear, cascaded and effectively enforced;
 - acknowledged weaknesses are well-known and some have been long-standing; and
 - risk culture is not well understood, and therefore may not be reinforcing the desired behaviours
- Boards to report back on reform and remediation
- Additional capital requirements to big 4 banks and Allianz Insurance



ASX Corporate Governance Principles and Recommendations 4th Ed

- Released February 2019
- Applies to listed entities on ASX
- Operates on an “if not, why not” basis
- Often seen as benchmark of good governance for other entities (NFP, LPCs)
- Specific principle of instilling a culture of acting **Lawfully, Ethically** and **Responsibly**
- Companies should have a Code of Conduct
- Board should be informed of any material breaches of the code of conduct



Governance in 2020

The role of the board and the corporation

- Who are the duties owed to? Shareholder primacy under attack
- the growth of “soft” obligations, community expectations and ASIC’s “Fairness Imperative”
- Ask “should we” rather than “can we”
- Getting the balance right (can’t be so consumed with non-financial risk that innovation or strategy suffers)

Role of board and management

- “constructive skepticism”
- Independently testing information (Centro/Vocation cases)
- “show me” don’t “tell me”

Focus on non-financial risk

- “chronic unease”
- Getting conduct and culture right is a competitive necessity

Making sure directors are getting the right information, at the right time and acting upon in a timely way

- Reaction times to bad news need to be faster



Corporate Culture

- **What is culture?**
- **7 signs of a toxic culture:**
 - Strain
 - Obstructed communications
 - Normalisation of deviance
 - Blame shifting
 - Neutralisation
 - Opportunity
 - Corporate Cognitive Dissonance
- **How do boards effectively oversee and test culture?**
- **Regulators/Inquiries continuing emphasis on self assessments and self-reporting**



Remuneration and Incentives

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APRA issued an updated standard on *Governance* which came into effect on 1 July 2019. It sets out minimum foundations for good governance of an APRA-regulated institution.

In Nov 19, APRA released an information paper *Transforming governance, culture, remuneration and accountability: APRA's approach*. APRA has committed to strengthening and intensifying its approach to overseeing governance, culture, remuneration and accountability (GCRA).



Remuneration and Incentives (cont.)

APRA to focus on misconduct, compliance and other non-financial risk in supervision of bank remuneration.	In July 19, APRA released a draft prudential standard <i>CPS 511 Remuneration</i> to clarify and strengthen remuneration requirements and accountability arrangements for regulated entities.
APRA should set limits on use of financial metrics in connection with long-term variable remuneration.	
FIs should review at least once a year the design of remuneration for front-line staff.	Gov. expects all financial services entities to monitor remuneration arrangements on an ongoing basis, as recommended.
Banks should fully implement recommendations of the Sedgwick Review (2017 Retail Banking Remuneration Review Report).	In March 19, ABA released Sedgwick's interim review into the progress of banks on the implementation of the recommendations from the 2017 Report. The review found that substantial progress has occurred.



Remuneration and Incentives

- Enhanced regulation and intervention by APRA
- Statutory restraints on incentives in BEAR
- Full implementation of Sedgwick recommendations for retail employees
- Are “balanced scorecards” a thing of the past?
- Intermediated business models on life support
 - Mortgage broker reforms
 - Financial adviser grandfathered commissions eliminated
 - POS exemption removed
 - Heavy regulation of add-on insurance



Individual Accountability

BEAR to be extended to APRA regulated superannuation trustees and insurers.	Legislation to be introduced by the end of 2020.
Responsibility within each entity governed by BEAR for all steps in the design, delivery and maintenance of all products and remediation of customers for those products.	APRA will require ADIs to identify and register accountable persons to hold end-to-end product responsibility for each product the ADI offers to its customers. Expected to implement the new requirements by 1 July 2020. In Dec 2019, APRA announced that it was delaying consultation on the implementation of product responsibility requirements.
APRA and ASIC to internally formulate and apply accountability principles similar to BEAR.	Dec 2019 - ASIC announced that it had updated its internal governance framework and implemented a new accountability regime. Dec 2019 - APRA published a document outlining its governance arrangements, along with accountability statements for its senior executives, <i>Governance and Senior Executive Accountabilities</i> .

What's the BEAR?

- The Banking Executive Accountability Regime (**BEAR**) applies to authorised deposit-taking institutions (**ADIs**) and their subsidiaries
- ‘Accountable Persons’ of the ADI are also subject to some BEAR obligations.
- Directors and executives of an ADI will be “Accountable Persons” if they have responsibility relating to the ADI for any of the Prescribed Responsibilities or meet a “General Principle” test.
- BEAR commenced
 - for large ADIs on 1 July 2018 (those with at least \$100 billion in resident assets)
 - for all other ADIs, on 1 July 2019





What's the BEAR? (cont.)

	Summary of obligations
Accountability	<ul style="list-style-type: none">• General standards of good conduct, including honesty, care and diligence, and dealing openly with APRA.• Reasonable steps to prevent adverse effect on prudential standing or reputation of the ADI.
Key personnel	<ul style="list-style-type: none">• Responsibilities of Accountable Persons must cover all operations and specified functions.• Accountable Persons must not be unregistered or banned persons.• ADIs must comply if APRA directs them to reallocate responsibilities.
Notification	<ul style="list-style-type: none">• APRA must be given an accountability statement for each Accountable Person, and an accountability map.• APRA must also be advised of certain events in relation to Accountable Persons and breaches of the accountability obligations.
Deferred remuneration	<ul style="list-style-type: none">• A portion of variable remuneration for Accountable Persons must be deferred for at least 4 years.



What's the BEAR? (cont.): Penalties

- **Civil Penalties for ADIs (not individuals):**
 - Up to **\$210m** for large ADIs
 - Up to **\$52.5m** for medium ADIs
 - Up to **\$10.5m** for small ADIs
- **Disqualification of individuals:**
 - APRA can remove and disqualify a person from being or acting as an Accountable Person if the person has not complied with accountability obligations
- **No indemnification:**
 - ADIs and Accountable Persons can't be indemnified or obtain insurance to cover consequences of breaching BEAR



Individual Accountability

- Community expectation of individual “scalps”
- More frequently individuals subject to accessorial liability or stepping stone liability
- BEAR expansion
- Targeting individuals (raids, search warrants, prosecutions)
- Immunity and cooperation (compare US experience)
- BEAR obligation to cooperate
- Changes to dishonesty for criminal prosecutions
- Major changes if ALRC recommendations on criminal accountability are adopted
- Increased power for ASIC to ban individuals
- Danger of pendulum swinging too far resulting in:
 - Deterring capable people from taking up senior executive roles and board positions
 - Chill innovation and entrench a risk adverse culture
 - Increase D&O premiums



Consumer Protection

ASIC approved codes may have enforceable provisions (i.e.: a breach of the code is a breach of the law)	Gov. released a consultation paper, <i>Enforceability of financial services industry codes</i> in March 2019
Banking Code of Conduct to designate provisions dealing with contract between bank and customer to be designated as enforceable Code provisions	Gov. expects the ABA to work co-operatively with ASIC to have relevant provisions of the Banking Code approved as 'enforceable code provisions' as soon as practicable after legislation providing ASIC with these powers has been enacted
Insurance in Superannuation Code, General Insurance Code of Practice and the Life Insurance Code of Practice to have enforceable code provisions by 30 June 2021	Gov. expects this to occur as soon as possible after legislation providing ASIC with powers is passed
Life Insurance Code of Practice and General Insurance Code of Practice to obtain sanction power for subscribers who breach codes	Gov. expects the this will occur as soon as possible. New Code of Practice approved, including sanctions to be operational early 2020



Consumer protection

- Shift from disclosure to pre-emptive action
- Product intervention power (PIP) and design and distribution obligations (DADO)
- Rise of soft obligations (community expectations, fairness, unconscionability)
- Civil penalty for not providing financial services “efficiently, honestly and fairly”
- Senate Economics Reference Committee Inquiry into Credit and Financial services targeted at Australians at risk of financial hardship (“off-Broadway Royal Commission”)
- Financial counselling services review
- AFCA expanded jurisdiction (small business, superannuation and legacy complaints)
- BEAR requires specific person accountable for products and remediation if those products cause harm.



Other countervailing powers

- Strengthened whistleblower protections now in force
- Shareholders (3 strikes) and activist shareholders
- Class actions
- Public opinion and parliamentary accountability
- Greater volume and transparency of information
- Industry codes with statutory force reflecting “fairness” and “community expectations”
- Licence conditions requiring cooperation with dispute resolution



Some thoughts in closing...

- What is the 2019 scorecard on change?
- What lessons have been learnt?
- What will be the BRC's legacy?
- Is the program of regulatory change overreacting and overreaching?