BANKING ROYAL COMMISSION RUNDOWN: THE FINDINGS OF THE FINAL REPORT

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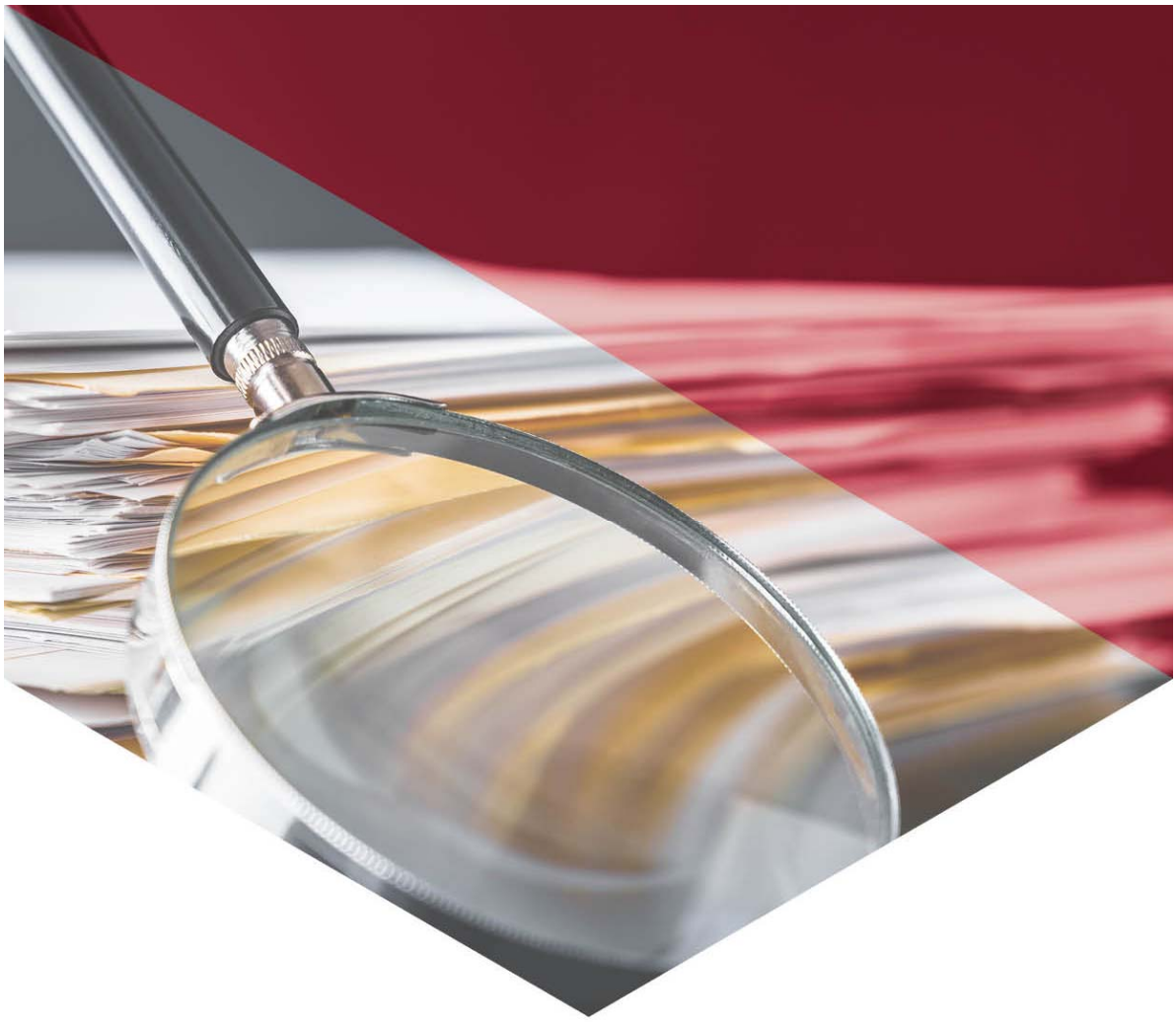
'Where is the wisdom we have lost in knowledge? Where is the knowledge we have lost in information?' - TS Eliot



February 2019

A great deal of information has been published by, and about, the Banking Royal Commission. Billions of words. This sea of information now includes the latest wave – all the analysis that's been published by the media and many interested parties over the last few weeks.

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Banking Royal Commission**) handed down 76 recommendations in the Final Report released on 4 February 2019.[1] The Federal Government has agreed to implement 75 of the 76 recommendations due to their reluctance to supress mortgage brokers.[2] Although Labor initially announced that if elected they will implement all recommendations in full,[3] they have since changed their position regarding mortgage broker commissions.[4]

The Final Report is a scathing assessment of the culture, conduct and compliance of the financial sector. It highlights the importance of profits to financial institutions above basic standards of honesty. This culture is reflected in company remuneration policies, as nearly all instances of misconduct identified were connected to the possibility of monetary benefit. The Final Report observes that this poor behaviour of the financial sector has gone relatively unchecked, with misconduct being punished inadequately, or not punished at all. In this respect, regulators, the Australian Securities and Investments Commission (**ASIC**) and the Australian Prudential Regulation Authority (**APRA**) have come under fire for rarely seeking public denunciation in the courts as a form of punishment for misconduct. This article highlights the main recommendations put forth by the Honourable Kenneth Maddison Hayne AC QC.

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[1] All statements expressed in this article are statements of the Banking Royal Commission and not our opinion unless otherwise stated.

[2] Phillip Coorey, 'Banking Royal Commission Final Report: Coalition Pulls Punches on Broker Crackdown' *Financial Review* (Online), 4 February 2019.

[3] Ibid.

[4] Michael Roddan, 'Labor backflip on mortgage brokers earns ridicule from Treasurer' *The Australian* (Online), 22 February 2019.

1. What were the Banking Royal Commission Terms of Reference?

The Banking Royal Commission was required to inquire into misconduct in financial services. Consequently, it may appear as a one sided report, as it was not required to examine conduct overall. The Terms of Reference[5] for the Banking Royal Commission were:

1.1 whether any conduct by financial services entities (including by directors, officers or employees of, or by anyone acting on behalf of, those entities) might have amounted to misconduct, and, if so, whether the question of criminal or other legal proceedings should be referred to the relevant Commonwealth, State or Territory agency[6]

1.2 whether any conduct, practices, behaviour or business activities by financial services entities fall below community standards and expectations[7]

1.3 whether the use of financial services entities of superannuation members' retirement savings, for any purpose, does not meet community standards and expectations or is otherwise not in the best interest of members[8]

1.4 whether any findings in respect to the matters mentioned above are attributable to[9]:

(a) the particular culture and governance practices of a financial services entity or broader cultural or governance practices in the relevant industry or relevant sector[10], or

(b) result from other practices, including risk management, recruitment and remuneration practices of financial services entity or in the relevant industry or relevant subsector[11]

1.5 the effectiveness of mechanisms for redress for consumers of financial services who suffer detriment as a result of misconduct by financial service entities[12]

1.6 the adequacy of[13];

(a) existing laws and policies of the Commonwealth (taking into account law reforms announced by the Commonwealth Government) relating to the provision of banking, superannuation and financial services

(b) the internal systems of financial service entities, and

(c) forms of industry self-regulation, including industry codes of conduct

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[5] Commonwealth of Australia, Royal Commission into Misconduct in the Banking and Superannuation and Financial Services Industry, *Appendices* (2019) vol 3, 1-7.
[6] Ibid 3 [a].
[7] Ibid [b].
[8] Ibid [c].
[9] Ibid [d].
[10] Ibid 3.
[11] Ibid.
[12] Ibid [e].
[13] Ibid [f].

to identify, regulate and address misconduct in the relevant industry, to meet community standards and expectations and to provide appropriate redress to consumers

1.7 the effectiveness and ability of regulators of financial services entities to identify and address misconduct by those entities[14]

1.8 whether any further changes to any of the following are necessary to minimise the likelihood of misconduct by financial services entities in future (taking into account any law reforms announced by the Commonwealth Government)[15];

(a) the legal framework

(b) practices within financial services entities, and

(c) the financial regulators

1.9 any matter that has occurred or is occurring overseas, to the extent the matter is relevant to a matter mentioned in paragraphs 1.1 to 1.8[16], and

1.10 any matter reasonably incidental to matters mentioned in paragraphs 1.1 to 1.9[17]

1.11 and, without limiting the scope of the inquiry or the scope of any recommendations arising out of the inquiry that may be considered appropriate, for the purpose of inquiring and recommendations in relation to the matter mentioned in paragraph 1.8[18]

(a) have regard to the implications of any changes to laws that it proposes to recommend, for the economy generally, for access to and the cost of financial services for consumers, for competition in the financial sector and for financial system stability;[19]and

(b) have regard to comparable international experience, practices and reforms.[20]

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[14] Ibid 4 [g].
[15] Ibid [h].
[16] Ibid [i].
[17] Ibid [j].
[18] Ibid.
[19] Ibid [k].
[20] Ibid [l]

2. Who was appointed to the Banking Royal Commission?

The Banking Royal Commission was established on 14 December 2017 by the Governor General of Australia, His Excellency General the Honourable Sir Peter Cosgrove AK MC (Retd). The Governor General issued letters which formally appointed the Commissioner, the Honourable Kenneth Madison Hayne AC QC.[21] Prior to the issuing of the Letters of Patent:

(a) Ms Toni Pirani of the Attorney General's Department was nominated to act as the Chief Executive Officer of the office of the Royal Commission (ORC);[22]

(b) the Attorney General appointed Ms Rowena Orr QC, Ms Eloise Dias and Mr Mark Costello as counsel assisting the Royal Commission;[23]

(c) Mr Michael Hodge QC and Mr Albert Dinelli were also appointed as counsel assisting the Royal Commission;[24] and

(d) the Australian Government Solicitor retained additional counsel to prosecute the work of the Royal Commission in Ms Claire Scheider, Ms Sarah Zeleznikow, Mr Mark Hosking and Mr Tim Farhall.[25]

3. How did the Banking Royal Commission come about?

The Banking Royal Commission arose following concerns in the industry brought to light by whistle-blowers such as Jeff Morris (an ASIC whistle-blower), politicians such as Senator John Williams (who previously sat on a 2009 joint Parliamentary Committee inquiry into the failure of a number of wealth managers, listening to accounts of the victims of poor and often fraudulent practices) and journalists such as Adele Ferguson (who published numerous stories on rogue financial planners in 2013).[26]

At its core, the Royal Commission was primarily concerned with the banking industry's promotion of an aggressive sales-driven approach, which emphasised profits at any cost.[27]

While the Turnbull Government publicly dismissed the idea of a Banking Royal Commission, Nationals Senator Barry O'Sullivan drew up legislation to support the inquiry and had the support to pass it through both houses.[28] In response, the Big Four Banks wrote to then Treasurer, Scott Morrison suggesting that a Banking Royal Commission would be in the 'national interest for the political uncertainty to end'.[29] Their letter was published in national newspapers. It seems the Big Four Banks thought it beneficial to establish an inquiry by a government who continued to resist an inquiry,

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[21] Ibid 2.
[22] Ibid 55.
[23] Ibid.
[24] Ibid.
[25] Ibid.
[26] Stephen Letts, 'The Whistleblower, Politician and Journo Who Hauled the Banks Before a Royal Commission', *ABC News* (Online) 1 February 2019.
[27] Commonwealth of Australia, Royal Commission into Misconduct in the Banking and Superannuation and Financial Services Industry, *Appendices* (2019) vol 1, 2.
[28] Lucy Sweeney, 'Malcolm Turnbull Backflips on Banking Royal Commission After Big Four Call for Inquiry to Restore Public Faith', *ABC News* (Online) 30 November 2017.
[29] Ibid.

rather than the willing backbenchers, Labor or the Greens who had countless people wishing to testify.[30] This ultimately led to Malcolm Turnbull's acceptance of the Banking Royal Commission.[31]

4. What topics did the Banking Royal Commission cover?

The Banking Royal Commission covered banking, financial advice, superannuation, insurance, culture, governance and remuneration and regulators. In addition the Banking Royal Commission Final Report also discussed other important steps, such as pending proposals, legal assistance and financial counselling services and the need for simplification so that the law's intent is met.[32]

5. What were the key findings and recommendations overall?

5.1 Banking

The Banking Royal Commission was concerned with 'traditional banking services'[33] and whether the current norms (financial services law and/or Banking Code of Practice) should be amended. The main authorities which are relevant here are the responsible lending provisions in the National Consumer Credit Protection Act (**NCCP Act**), the Banking Code of Practice, consumer protection provisions and unfair contract terms provided under the ASIC Act.[34]

The Interim Report concluded that there had been conduct which may amount to contravention of the NCCP Act, particularly not to enter a credit contract unless inquiries and verifications about the credit contract's suitability have been undertaken.[35] The Commissioner also highlighted that senior executives within an organisation may be held accountable for having administration and IT systems in place[36]. They cannot escape responsibility by delegating these functions to a different internal team[37].

Since the first round of the Commission's hearing, many banks have altered lending processes by introducing additional inquiries into a borrower's financial situation which has led to less reliance on the Household Expenditure Measure (**HEM**).[38] Due to the current prevalence of making further inquiries into income and expenses, the NCCP Act should not be amended to alter the obligation to assess unsuitability of a credit contract.[39] Given the steady movement away from reliance on the HEM, it is likely that there will be an increase in the use of digital technology to compile customer home and expense data in order to further reduce the reliance on the HEM.

Two distinct forms of intermediated lending were examined and dealt with separately.

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[30] Ibid.

[31] Ibid.

[32] Commonwealth of Australia, Royal Commission into Misconduct in the Banking and Superannuation and Financial Services Industry, *Final Report* (2019) vol 1, vii xxii.

[33] For the purpose of this article, 'traditional banking services' are defined as lending, deposit taking and the provision of transaction services.

[34] Commonwealth Government of Australia, Above n 32, 51.

[35] Ibid 54.

[36] Ibid

[37] Ibid.

[38] Ibid 57.

[39] Ibid 60 [Recommendation 1.1].

(a) Home lending via mortgage brokers[40]

This is the most controversial recommendation of the Banking Royal Commission. Initially Labor accepted this recommendation and Liberal accepted all recommendations other than this one. As at 22 February 2019, Labor announced it will permit banks to pay brokers an upfront commission and so rejected the Banking Royal Commission's mortgage broker recommendation.[41] Instead, Labor proposes that lenders can pay an upfront fee of 1.1% maximum of the home loan draw down amount to buy real estate (excluding any additional amounts borrowed say, to buy a car).[42] The proposed 1.1% is twice the 0.54% currently charged for an upfront fee and compensates for the abolition of trail commissions.[43]

The best interest duty that the Corporations Act imposes on those who provide personal advice to retail clients does not apply to a mortgage broker.[44] The findings of the Commission revealed common instances where brokers had passed on information to the lender which was wrong or they joined forces with the borrower or employees of the lender to deceive the lender.[45] The fact that the broker is only paid if the loan application succeeds is a clear motive for this conduct. Furthermore, as the amount paid varies with the amount of the loan, brokers are incentivised to have borrowers take as large a loan as possible, regardless of whether the borrower needs it or whether it is wise to borrow that sum.[46]

In consideration of these aspects, it was recommended that when brokers act in connection with home lending, they must act in the best interests of the intending borrower. This should be enforceable by a civil penalty.[47]

As long as brokers are seen by borrowers to be acting on their behalf, the problem that present remuneration arrangements are conflicted remains unsolved. Therefore, the borrower, not the lender should pay the broker a fee for acting in connection with home lending. These changes should be made over a two or three year period.[48] Initial changes should also prohibit lenders from paying trail commission to brokers for new loans.[49] Further changes should be made later to prohibit lenders from paying other commissions to brokers.[50]

Despite brokers playing a predominantly advisory role, obligations under the *Corporations Act* regarding the provision of financial product advice to retail clients does not apply to giving advice on residential home loans. This, coupled with the fact that a broker is only paid if a loan application succeeds is an obvious motive for misconduct. The Banking Royal Commission recommended that

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[40] Ibid 61.
[41] Christopher Joye, 'Labor rejects royal commission via mortgage broker backflip', *Australian Financial Review* (22 February 2019) https://www.afr.com/personal-finance/banking/labor-rejects-royal-commission-via-mortgage-broker-backflip-20190222-h1bkzj.
[42] Phil Coorey, 'Labor wants new bank levy to boost compensation scheme', *Australian Financial Review* (21 February 2019) https://www.afr.com/news/labor-pledges-new-bank-levy-for-compo-scheme-boost-20190221-h1bitj.
[43] Ibid.
[44] (2001).Division 6.
[45] Ibid 65.
[46] Ibid.
[47] Ibid 73 [Recommendation 1.2].
[48] Ibid 76.
[49] Ibid.
[50] Ibid 80 [Recommendation 1.3].

brokers should be subject to the law that applies to entities providing financial product advice to retail clients.[51]

Interestingly, most broker remuneration came to consist of an upfront fee plus trail commissions at the instigation of lenders. This was to prevent "mortgage churn." It seems obvious that unless a broker has a "best interests duty" for example, to act in the best interests of the borrower, mortgage churn will increase if the Labor policy is followed. If a broker gets paid upfront, then twelve months later the broker could help the borrower refinance and the broker will again be paid upfront. The system of commissions, trails and a best interests duty seems less likely to deliver effective results.

(b) Motor vehicles and consumer goods through point-of sale exceptions to the NCCP Act[52]

Consumers may borrow money in order to purchase motor vehicles, whitegoods and furniture, which typically have high upfront costs but long useful lives. Often, the application for credit is made at the point of sale, not at the lender's premises. The person the consumer deals with at the point of sale is not subject to the NCCP Act due to the point-of-sale exemption.[53] It was recommended that the exemption of retail dealers from the operation of the NCCP Act should be abolished.[54] If the point-of-sale exemption is removed, it will have a significant impact on how consumer products are sold. As previously discussed, lenders may explore new distribution models as traditional models for home loans, automotive finance and co-branded credit cards come under fire. Whilst this may ameliorate concerns relating to gaps in regulatory oversight, it may lead to extended liability through dealers or retailers acting as their agents. Further, for lower cost products, the removal of the exemption may create further reliance on non-NCCP regulated credit, both in store and online, such as buy-now-pay-later arrangements.

It is clear from the inquiry that not all Australians have the same access to telephone or internet banking, and not every Australian is proficient with English.[55] These factors were addressed through the recommendation that the Banking Code of Practice be amended to ensure that banks work with customers in remote areas, as well as those who are not well versed in English by highlighting a suitable way for those customers to undertake banking.[56] Further, where a customer finds difficulty with providing identity documents and identifies as Aboriginal or Torres Strait Islander, the bank will follow AUSTRAC's guidance on identification and verification.[57] Within this recommendation it was also suggested that banks will not allow informal overdrafts on basic accounts without prior agreement, or charge dishonourable fees on basic accounts. [58]

It was deduced that there was no great need to change the lending framework for small business' and as such the NCCP Act should not be amended to extend its operations.[59] However, to avoid confusion, the Australian Banking Association should amend the definition of 'small business' so that

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[51] Ibid 82 [Recommendation 1.5].
[52] Ibid 84.
[53] NCCP Regulations reg 23.
[54] Commonwealth of Australia, Above n 32, 84 [Recommendation 1.7].
[55] Ibid 252.
[56] Ibid.
[57] AUSTRAC, *Aboriginal and/or Torres Strait Islander People (13 December 2019) AUSTRAC* www.austrac.gov.au/aboriginal-andor-torres-strait-slander-people.
[58] Commonwealth of Australia, Above n 32, 94 [Recommendation 1.8].
[59] Ibid 96 [Recommendation 1.9].

it applies to businesses employing less than 100 full time equivalent employees, where the loan applied for is less than $5 million.[60]

This was somewhat surprising, as many small businesses mortgage the family home in order to secure small business finance, many commentators expected the Banking Royal Commission to recommend some further protection for small business lenders.

In addition, it was expected that protections will be recommended for primary producers who mortgage the "family farm" which includes the family home to secure business finance.

Whilst New South Wales, Victoria, Queensland and South Australia have legislation for farm debt mediation,[61] it is often seen as a step that must be taken in order to take enforcement action. To create uniformity, it was suggested that a national scheme should be enacted.[62] Further, APRA should amend prudential standards to require internal appraisals of land taken as security to be independent from loan origination and processing as well as providing for a fairer valuation of agricultural land.[63] The Banking Code of Practice should also be amended so that banks will not charge interest on loans secured by agricultural land affected by drought or natural disaster.[64] In addition, when dealing with distressed loans, banks should ensure they are managed by agricultural bankers, offer farm debt mediation as soon as the loan is classified as distressed, recognise that the appointment of receivers is an action of last resort and cease charging interest when there is no realistic prospect of recovery.[65]

5.2 Enforceable Code provisions

The Banking Royal Commission Final Report mandates that a breach of an enforceable code provision should constitute a breach of the law. Subsequently, remedies that flow on from that breach would be modelled on Part VI of the Competition and Consumer Act. In order to identify enforceable code provisions, the following steps are necessary;

- the industry should identify the provisions that it says govern the terms of the contract made or to be made between the financial services entity and the customer or guarantor;
- the industry should seek ASIC's approval of those provisions;
- ASIC should review those provisions; and
- once approved, they will be enforceable by statute. Customers would have the power to elect any breaches of those provisions through existing internal or external dispute resolution mechanisms or through the courts.

ASIC's role should go beyond being the passive recipient of proposals but should extend to assessing whether the industry has identified provisions that should be made enforceable code provisions.

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[60] Ibid 94 [Recommendation 1.8].
[61] *Farm Debt Mediation Act 1994* (NSW); *Farm Debt Mediation Act 2011* (Vic); *Farm Business Debt Mediation Act 2017* (Qld; *Farm Debt Mediation Act 2018* (SA).
[62] Commonwealth of Australia, Above n 32,102 [Recommendation 1.11].
[63] Ibid [Recommendation 1.12].
[64] Ibid 103 [Recommendation 1.13].
[65] Ibid 104 [1.14].

Therefore, ASIC must ensure that all terms governing the contract have been identified. Additionally, these provisions should be expressed clearly and unambiguously.

It is important to note, by creating a system of enforceable provisions, ASIC's existing and general power under s 1101A of the Corporations Act will not be displaced. Secondly, the proposed model is intended to supplement, rather than derogate from, existing internal and external dispute resolution mechanisms. Experience shows that systemic issues identified by the Financial Ombudsman Service (**FOS**), or revealed in the course of determining individual disputes, have not always been resolved in ways that encourage compliance with norms.[66]

Finally, the Final Report proposed to amend the law to enable ASIC to consider whether particular provisions of an industry code of conduct have been designated as 'enforceable code provisions' in determining whether to approve a code. This is especially important within the banking and insurance industry as non-enforceable provisions play an important role in setting standards of behaviour over time.

5.3 Financial Advice

One of the most significant issues which emerged in connection with the provision of financial advice is that clients were given poor advice, leaving them in significantly worse positions.[67] This is because advisers and licensees benefit from clients acting on their advice, thus creating a conflict of interest depending on the advice given.[68] In order to combat this, it was recommended that the law be amended to require financial advisors who use any restricted words in s 923A(5) of the Corporations Act such as 'independent', prior to the provision of personal advice, to give a written statement explaining why the adviser is not independent.[69] In addition, amendment/s could also be made to s 961B of the Corporations Act which obliges financial advisers to act in the best interest of the client in relation to the advice.[70] It was suggested that a review be conducted in three years time to, among other things, consider repealing s 961B(2) if there is no clear justification for its retention.[71]

Whilst reforms have included a ban on conflicted remuneration,[72], few exceptions to the ban remain.[73] One being for 'grandfathered' commissions (accounts set up prior to July 2013) which are ongoing payments from a superannuation, investment or insurance accounts which are paid to a financial advisor.[74] Since this is essentially a form of conflicted remuneration, it was suggested that grandfather provisions be repealed.[75] Similarly, an exception exists for commissions on life insurance risk products.[76] The suggestion aims to wait until ASIC conducts its review of conflicted remuneration relating to life risk insurance products and should consider reducing the cap on commissions to zero.[77] The ASIC review should also consider whether each remaining exemption to the ban on

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[66] FSRC, *Interim Report,* vol 2, 298-302.
[67] ASIC, *Report 562: Financial Advice: Vertically Integrated Institutions and Conflicts of Interests,* January 2018, 36 [137].
[68] Commonwealth of Australia, above n 25,139.
[69] Ibid176 [Recommendation 2.2].
[70] Ibid 178 [Recommendation 2.3].
[71] Ibid.
[72] Conflicted remuneration being any benefit given to a financial services licensee which could reasonably influence the choice of financial product recommended to retail clients.
[73] Commonwealth of Australia, above n 32, 180.
[74] *Corporations Regulations* 2001 (Cth) reg 7.7A.
[75] Commonwealth of Australia, above n 32, 185 [Recommendation 2.4].
[76] *Corporations Regulations* 2001 (Cth) reg 7.7A.11B.
[77] Commonwealth of Australia, above n 32, 189 [Recommendation 2.5].

conflicted remuneration remains justified.[78] In light of these recommendations, financial services licensees should review the commentary in the Banking Royal Commission's final report to identify and eliminate inherent conflicts of interest in their remuneration systems.

In many circumstances where financial advisers received poor audit results, there was generally no, or insignificant, consequences for the advisers.[79] In order to ameliorate this, all AFSL holders should be required to report serious compliance concerns about advisers to ASIC quarterly.[80] Further, where an AFSL holder detects that a financial adviser has engaged in misconduct, they should be required to make inquiries into the extent of the misconduct, tell the affected clients and remediate them promptly.[81]

5.4 Superannuation

The key findings and recommendations for superannuation are split into four separate categories, being trustees obligations, 'selling' superannuation, nominating default accounts and regulation.

In relation to trustees obligations, the report stipulates that the trustee of an Registerable Superannuation Entity (**RSE**) should be prohibited from assuming any obligations other than those which arise from the duties of a trustee of a superannuation fund.[82] Furthermore, deduction of any advice fee (other than intra-fund advice) from MySuper account should be prohibited.[83] However, whilst advice fees should be prohibited where there are requirements for annual renewal, prior written identification of service, provision of clients written authority and ongoing fee arrangements may be deducted.[84]

The main recommendation for selling superannuation is that hawking, being the unsolicited offer or sale of superannuation, should be prohibited.[85] The Commissioner recommended that the law should be amended to make clear that contact with a person during which one kind of product is offered is unsolicited unless the person attended the meeting, made or received the telephone call, or initiated the contact in relation to the offer of that kind of product. More specifically, the general prohibition made by s 992A(1) of the Corporations Act that a person must not offer financial products for issue or sale in the course of, or because of, an unsolicited meeting with another person, and the associated prohibition in s 992A(3) against telephone selling, ought to apply to superannuation. An exception can be made for non retail clients, where offers are made under an eligible employee share scheme.[86]

Nominating a default fund is essential as is it thought that many young individuals may not make informed choices about their superannuation arrangements. Superannuation accounts should only be created for new workers, or workers who do not already have a superannuation account. This should be 'stapled' to members as they move jobs.

Furthermore, s 68A of the Supervision Industry (Supervision) Act provides that a trustee of an RSE, or an associate of a trustee, must not supply or offer to supply goods or services to a person 'on the

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[78] Ibid 190 [Recommendation 2.6].
[79] Transcript of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Michael Wright, 19 April 2018, 1422.
[80] Commonwealth of Australia, above n 32, 205 [Recommendation 2.8].
[81] Ibid [Recommendation 2.9].
[82] Ibid 229 [Recommendation 3.1].
[83] Ibid 241 [Recommendation 3.2].
[84] Ibid 243 [Recommendation 3.3].
[85] Ibid 250 [Recommendation 3.4].
[86] Ibid.

condition that one or more of the employees of the person will be, or will apply or agree to be, members of the fund'. The Final Report recommends this should be amended to prohibit trustees of a regulated superannuation fund, and associates of a trustee, where any of the acts specified may reasonably be understood by the recipient to have a substantial purpose of having the recipient nominate the fund as a default fund or having one or more employees of the recipient apply or agree to become members of the fund. This should exist as a civil penalty enforceable by ASIC.

Finally, the regulatory focus for superannuation must extend to the outcomes that will be delivered to members. The performance of superannuation directly affects the public 'purse' by reducing the call on social security payments and other public welfare measures such as housing, care and health measures. However, the Productivity Commission recently stated in its report on superannuation that 'conduct regulation arrangements for the superannuation system are confusing and opaque, with significant overlap and no clear delineation between the roles of APRA and ASIC.'[87] This regulatory overlap widens the scope for doubt about which regulatory agency will and should act in any given circumstance.

5.5 Insurance

The Banking Royal Commission focused on the life and general insurance industries consistent with the complaints made to the Commission on misconduct falling below community standards. Similar to that of the superannuation industry, it was suggested that hawking of insurance products be prohibited.[88]

The statistics relied on in the Commission, gathered by ASIC, suggested that funeral insurance policies sold directly to consumers may sometimes be of little value.[89] This is because many funeral insurance products have the potential for consumers to pay more premiums over the life of the policy than they will receive as a benefit upon death.[90] Therefore, the exclusion of funeral expenses policies should be removed from the definition of financial product and it should be highlighted that the consumer protection provisions of the ASIC Act apply to funeral expenses policies.[91] A Treasury-led working group should also develop an industry-wide deferred sales model for the sale of any add-on insurance products, except for comprehensive motor insurance.[92]

Currently, the unfair contract terms provisions set out in the ASIC Act do not apply to insurance contracts.[93] Historically, when the unfair contract term provisions were originally in draft they applied to insurance contracts. However, an amendment was made to the Insurance Contacts Act to carve out insurance contracts from the unfair contract term provisions. It is recommended that they should apply and the provisions should be amended to provide a definition of the dominant subject matter of an insurance contract as the terms of the contract that describe what is being insured.[94] The duty of good faith should operate separately from that of the unfair contract terms provisions.[95] Further, the duty of disclosure for consumers under the Insurance Contracts Act will be replaced with a duty to take reasonable care not to make a misrepresentation, essentially shifting the burden from the

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[87] Productivity Commission, Report 91, *Superannuation, Assessing Efficiency and Competitiveness,* 21 December 2018, 459.
[88] Ibid 284 [Recommendation 4.1].
[89] ASIC, Report 454, 29 October 2015, 14 [32].
[90] Ibid 20 [47].
[91] Ibid 288 [Recommendation 4.2]
[92] Ibid 292 [Recommendation 4.3].
[93] Ibid 303.
[94] Ibid 308 [Recommendation 4.7].
[95] Ibid.

consumer to the insurer. This is likely to increase the burden insurers face in seeking to minimise liability for a claim due to non-disclosure. Also, proving that a consumer failed to take reasonable care to not make the misrepresentation may well be a more difficult task than merely proving that they made a misrepresentation.

The handling and settlement of insurance claims is currently absent from the definition of financial service by regulation 7.1.33 of the *Corporations Regulations*. As a result, some general obligations in the *Corporations Act*, including the provision of honest financial services, are not applicable.[96] Therefore, it was recommended that the handling and settlement of insurance claims should no longer be excluded from the definition.[97]

As previously discussed, some provisions of the industry codes are necessary to be applied as law so that breaches of these provisions will constitute a breach of law. In regards to the Insurance Codes[98], the Financial Services Council, Insurance Council and ASIC should take all steps necessary by 2021 to have the provisions of those codes that govern terms of the contract as enforceable code provisions.[99] Similarly, provisions modelled on the BEAR Regime should be extended to all APRA-regulated insurers.[100]

Another key recommendation is to review the universal key terms in MySuper group life policies to explore the possibility of amending the law to require insurance terms in default superannuation products to be uniform.[101] Whilst this may make it easier for consumers to compare products, it is likely to be extremely difficult to implement standardised wordings across the industry.

5.6 Culture

Banks have recently made significant changes to the way their front line staff are remunerated, with many of these changes made in response to the Sedgwick Report. The Sedgwick Report was an independent review of retail banking remuneration commissioned by the Australian Banking Association and completed by Stephen Sedgwick AO in April 2017. It is recommended that all Sedgwick recommendations be implemented.[102]

In order to remedy the culture in this sector, APRA-regulated institutions should create a supervisory program which will foster a culture focused on mitigating the risk of misconduct. The review should be risk-based and entities should be encouraged to give adequate attention to the management of conduct risk and improving entity governance.[103]

5.7 Regulators

ASIC's remit is very large and has increased greatly since its establishment. While it was acknowledged that there may be some advantages to limiting some aspects of ASICs remit and

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[96] See also ASIC, Module 6 Policy Submission, 27 [107].

[97] Commonwealth of Australia, Above n 32, 310 [Recommendation 4.8].

[98] Life Insurance Code of Practice, Insurance in Superannuation Voluntary Code, The General Insurance Code of Practice.

[99] Ibid 314 [Recommendation 4.9].

[100] Ibid 318 [Recommendation 4.12].

[101] Ibid 257 [Recommendation 4.13]

[102] Commonwealth of Australia, Above n 32,375 [Recommendation 5.5].

[103] Ibid 393 [Recommendation 5.7].

requiring the ACCC to take responsibility, this was rejected in favour of retaining the 'twin peaks' model of regulation.[104]

The current system of regulation is deeply entrenched in a culture of negotiating outcomes rather than insisting on public denunciation and punishment for wrongdoing.[105] It is recommended that ASIC approaches enforcement by first asking whether a court should determine the consequences, particularly to enable specific and general deterrence.[106] In order to aid in the regulation of superannuation, the roles of APRA and ASIC should be reconciled to ensure that APRA is responsible for establishing and enforcing Prudential Standards which aim to ensure that financial promises made by superannuation entities are met within a stable financial system.[107]

In our experience, ASIC has focused on enforceable undertakings and used the appointment of independent experts to require compliance.. An examination of enforcement undertaking 'independent' experts suggests a certain concentration.

There has been limited analysis of legal obligations as part of enforceable undertakings. It appears that they focus more on negotiations between the parties and ASIC and that more focus should be placed on the law.

Furthermore, ASICs role should be extended, without limiting the powers of APRA, by having the ability to enforce all provisions under the Superannuation Industry (Supervision) Act which are or will be civil penalty provisions or will end in a cause of action against an RSE licensee or director for actions that may harm consumers.[108] APRA and ASIC should co-regulate all of these provisions.[109] Regardless of the modified powers of ASIC, APRA should retain all current functions.[110] ASIC and APRA should also jointly administer the BEAR Regime[111] and over time these provisions should be extended to all APRA-regulated institutions.[112]

The Banking Act should be amended to highlight that an ADI and an accountable person must deal with ASIC and APRA in an open and co-operative way and amendments should also be made to facilitate joint administration.[113]

The nature of co-regulation between ASIC and APRA should become entrenched to ensure that they co-operate and share information with each other.[114] In order to do this effectively, they should prepare and maintain a joint memorandum highlighting how they will comply with their obligation to co-operate.[115] APRA and ASIC should receive a new oversight authority which is independent of the government and requires a report on the effectiveness of each regulator.[116] It is expected ASIC will embrace the 'why not litigate' approach, due to these recommendations they are likely to become less willing to partake in negotiated outcomes which are limited to infringement notices, enforceable undertakings or voluntary donations.

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[104] Ibid 423 [Recommendation 6.1].
[105] Ibid 425.
[106] Ibid 446 [Recommendation 6.2].
[107] Ibid 454 [Recommendation 6.3].
[108] Ibid.
[109] Ibid 455 [Recommendation 6.4].
[110] Ibid [Recommendation 6.5].
[111] Ibid 457 [Recommendation 6.6].
[112] Ibid 458 [Recommendation 6.8].
[113] Ibid [Recommendation 6.7].
[114] Ibid 464 [Recommendation 6.9].
[115] Ibid [Recommendation 6.10].
[116] Ibid 480 [Recommendation 6.14].

5.8 Other Recommendations

The main recommendation in this section seeks to eliminate exceptions and qualifications to generally applicable norms of conduct in legislation governing all financial services entities.[117]

The Commission also recommends increased funding for legal assistance in order to help complainants take disputes to the Australian Financial Complaints Authority (**AFCA**).[118] Whilst the method of funding is not highlighted in the Final Report, there is a call for stable, rather than sporadic, funding for legal assistance services.[119] This is likely to increase AFCA's work and could increase the number of complaints being taken further than internal dispute resolution processes.

6. Responsibility for Wrongdoing – The Courts' Likely Approach

The underlying theme of the Banking Royal Commission was responsibility for wrongdoing which is a critical question for any financial service entity or officer facing allegations of misconduct. Integral to this, is the way in which Courts will attribute intention, motive and purpose of individuals to corporations in the wake of *ASIC v Westpac Banking Corporation (No 2)* [2018] FCA 751 (**Westpac Decision**).

Commissioner Hayne was of the view that the primary responsibility for misconduct should be sought from boards of directors and senior management for behaviour attributed to their institutions.[120] As such, it is likely that Courts will follow the judgment delivered by Justice Beach in the Westpac Decision. In order to allocate misconduct, Beach J identified that the conventional approach was to identify the 'directing mind and will' of the corporation regarding the relevant conduct and attribute that person's state of mind to the corporation.[121]

The test adopted in the Westpac Decision to attribute wrongdoing at law could result in unexpected or uncertain results for any prosecutions to come out of the Banking Royal Commission final report. This is because it requires the court to partake in a contextual analysis of the structure of financial service entities and the status and obligations of the individuals involved.

7. What was ASIC's response to the Banking Royal Commission?

ASIC is committed to accepting and implementing all 12 recommendations directed towards it in the Banking Royal Commission which do not require legislative changes. ASIC will also supervise implementation of 23 recommendations to impose new requirements or restrictions on the entities they regulate.

Whilst ASIC would not comment on any actual or potential investigations, they have announced that they will provide an update on the handling of the 11 specific case referrals from the Banking Royal Commission. ASIC's enforcement teams have also begun investigations into the 12 case studies which were heard at the Royal Commission and have commenced proceedings in relation to two other cases. ASIC is also looking into a further 16 cases to determine whether investigations are needed. It is expected that this will result in a number of referrals to the Commonwealth Director of Public Prosecutions for criminal prosecutions.

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[117] Commonwealth of Australia, Above n 32, 496 [Recommendation 7.3].
[118] Ibid 493.
[119] Ibid.
[120] Commonwealth of Australia, Above n 32, 333.
[121] *Australian Securities and Investments Commission v Westpac Banking Corporation* (No 2) [2018] FCA 751 [1660].

ASIC has commented on the need to change their culture to adopt a 'why not litigate?' stance which they publicly committed to in October 2018. Following the recommendations, ASIC is determined to establish a separate Office of Enforcement. A taskforce for its implementation has been put in place and completion is estimated for 2019.

ASIC has accepted that closer coordination with APRA will be needed in order to strengthen the 'twin peaks' model. They welcome the call for greater regulatory accountability via the establishment of a new oversight body and plan to be proactive in collaborating with them. The findings and observations in the Banking Royal Commission's final report will be the basis of ASIC's agenda moving forward. A large number of the recommendations made by the Banking Royal Commission involved reforms ASIC has previously advocated for. These changes will build on the existing reform agenda and changes introduced by the *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018.* Further, ASIC is ready and willing to work with the Government, Parliament and APRA in order to strive for a fair, strong and efficient financial system for all Australians.

8. Conclusions

The Banking Royal Commission has recommended sweeping changes to the financial services sector in order to combat the examples of misconduct heard by the Banking Royal Commission. We summarise below some of the key outcomes.

The Final Report recommends the consideration of criminal charges against organisations taking fees for services customers did not receive.

ASIC and APRA will have increased power to oversee superannuation and create civil penalties for breaches of law governing trustees and directors.

As a result of the Banking Royal Commission, the Government has now agreed to create a national farm-debt-mediation scheme in the wake of the report.[122] However, the rural community is visibly shaken by the commissions lack of time allocated to hear farmers stories at the Banking Royal Commission.[123] Further, receivers were exempt from the Commission despite a rural witness accusing them of causing significant destruction of value for farm businesses.[124]

Another contention appears to be that APRA and ASIC will receive greater oversight by an independent body, effectively regulating the regulators.

The Government has agreed to work with the regulators to ensure appropriate resources are given to them and will consider additional funding in the next budget.[125]

In order to more effectively deter and punish corporate wrongdoing, the *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2018* was passed by the Parliament.

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[122] Andrew Marshall, 'Banking Royal Commission: Far Debt Mediation Scheme Welcomed', *Farm Online National* (Online) 5 February 2019.
[123] Daniel Ziffer, 'Banking Royal Commission: Farmers Furious 'Not Enough Time Allocated' to Hear Their Stories, *ABC News* (Online), 22 June 2018.
[124] Marty McCarthy, 'Banking Royal Commission: 'Destructive' Rural Receivers Won't Be Questioned', *ABC News* (Online), 26 June 2018.
[125] Shane Wright, 'Frydenberg Tells Regulators to Go Hard in Wake of Royal Commission', *The Sydney Morning Herald* (Online), 14 February 2019.

Further, the impact of the report on mortgage brokers is extensive as the Banking Royal Commission recommends the industry move from a commission based to a fee based model, essentially making them advisers.[126]

Whilst the Banking Royal Commission has been received well by some, others argue that its solutions will not result in real change.[127] However, due to the case studies heard at the Banking Royal Commission, legislators are not likely to be inclined to allow exceptions which featured in the Future of Financial Advice reforms. Similarly, market participants will not be as active in advocating for them.

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[126] Samantha Maiden, 'Banking Royal Commission: Consumers to Pay Mortgage Brokers Directly, With No Trailing Commissions, *The News Daily* (Online), 4 February 2019.
[127] Graham Young, 'The Banking Royal Commission We Still Need', *Spectator Australia* (Online), 12 February 2019.