

TECHCONNECT

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Analysis of the Royal Commission's Final Report

Summary

After a weekend of considering Commissioner Kenneth Hayne's Royal Commission's Final Report into Misconduct in the Banking, Superannuation and Financial Services Industry (Final Report), Treasurer Josh Frydenberg announced the Government's agreement to action all of the Commissioner's 76 recommendations.

In a penetrating speech, the Treasurer pointed out that the sector, when measured against a benchmark of meeting community expectations, had failed. Trust in financial institutions had been lost and must be restored.

The Treasurer candidly made the point that the banking sector must change forever, and the primary responsibility for this lies with companies, their boards and senior management.

Noticeably, the vertical integration model was considered in detail and not altered. In simple terms the model is not the primary issue, it is that existing laws need to be more rigorously applied.

The Government is committed to ensuring the consumer's interest is put first, and to ensure this, the law will be simplified, regulatory powers and resources expanded whilst maintaining the twin peaks regulatory model. The principal focus is on restoring trust and better consumer outcomes whilst also encouraging the flow of credit and competition.

The theme of the Final Report is to:

- strengthen and expand consumer protection
- raise accountability and governance standards
- enhance the effectiveness of regulators
- provide effective remediation.

In future, mortgage brokers will be subject to the best interests duty, commissions (including grandfathered commissions) will be banned completely and the sector will be reviewed again in three years.

The Banking Executive Accountability Regime (BEAR) which ensures banks and their executives are held accountable when they fail to comply with their obligations will be extended to all Australian Prudential Regulation Authority (APRA) regulated entities, such as insurers and registrable superannuation entities (RSEs).

The Commissioner's overall philosophy is summed up in his own words. 'There is every chance that adding a new layer of law and regulation would serve only to distract attention away from the very simple ideas that must inform the conduct of financial services entities.'

These ideas are that entities should:

- obey the law
- 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 interests of that other.

The simplicity of these ideas point firmly towards a need to apply the existing law rather than add new layers of regulation. Because the more complicated the law, the easier it is to lose sight of its underlying purpose.

Superannuation faces some significant changes. Trustees and directors will be subject to civil penalties for breach of covenants. A breach of the trustees' and directors' covenants and certain obligations in relation to MySuper should be enforceable by action for civil penalty. January 2021 will see the end of grandfathered commissions, volume bonuses and dealer rebates. It is envisaged each new super member will only have one default account, similar to the recommendations made by the Productivity Commission. The hawking of ancillary benefits will be prohibited, as will the deduction of advice fees from MySuper accounts.

To ensure these reforms are implemented efficiently and effectively, the Treasury Royal Commission Taskforce (TRCT) will continue as a Financial Services Reform Implementation Taskforce (FSRIT). To ensure ongoing coordinated delivery of reforms, a Financial Services Reform Implementation Committee (FSRIC) will also be established consisting of the Treasury, Australian Securities and Investments Commission (ASIC), Australian Prudential Regulation Authority (APRA), the Office of the Parliamentary Counsel and other agencies as required.

Important information – for adviser use only

These are the Financial Services Royal Commission recommendations and the Government's response to them in 'pre-election mode'.

This is not yet law in its proposed or actual form.

The TechConnect commentary is not the official business position. It is merely observations.

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Financial advice

Before considering the recommendations in relation to financial advice, it is important to understand the framework through which the Commissioner is viewing the industry. The Commissioner contends that the financial advice industry is in a state of 'incomplete transformation' into a profession – but it is missing a number of key features and requires significant change before it can be deemed a profession (Volume 1, page 119).

Overall the Commissioner identified three areas of concern:

- Fees for no service.
- Poor advice.
- Lack of a consistent disciplinary system.

In relation to 'fees for no service', the Commissioner is of the view that 'Until satisfactory steps have been taken to deal with those involved in the charging of 'fees for no service', and to ensure that it does not happen again, the financial advice industry will lack the public respect and trust that is a necessary aspect of any profession.' (Volume 1, page 134). The Commissioner also highlights what he believes is a fundamental misunderstanding financial advisers have in relation to the difference between a commission and a fee – which has led to the creation of the 'fee for no service' issue. This is explained in Volume 1, page 132 which states, 'Unlike a trail commission, which is paid by the product issuer in recognition of the initial sale of the financial product, an ongoing fee is paid by the client, and is paid in exchange for the provision of a service.' The Commissioner does not accept the charging of fees for no service was accidental, a processing error or oversight (Volume 1, page 139).

In relation to the provision of poor financial advice, the main concern the Commissioner has is around conflicts of interest. From the report, (Volume 1, page 135) he states, 'Other professions do not have such faith in the notion that conflicts of interest and conflicts between duty and interest can be effectively managed. Until something is done to address these conflicts, the financial advice industry will not be a profession' (Volume 1, page 135).

The report also advocates the need for a stronger, more 'coherent' disciplinary scheme which removes the challenges ASIC faces, namely 'the existing disciplinary arrangements for financial advisers are fragmented and hampered by inadequate sharing of information' (Volume 1, page 135).

The Commissioner is in favour of moving financial advice towards it being a profession, particularly as the identified alternative would be to have advisers simply 'act as salespeople, and be clearly identified as such' (Volume 1, page 135).

2.1 Annual renewal and payment of fees

Royal Commission's recommendation

The law should be amended to provide that ongoing fee arrangements (whenever made):

- must be reviewed annually by the client
- must be recorded in writing each year the services the client will be entitled to receive and the total of the fees that are to be charged, and
- may neither permit nor require payment of fees from any account held for, or on behalf of, the client *except* on the client's express written authority to the entity that conducts that account given at, or immediately after, the latest renewal of the ongoing fee arrangement.

Government response

The Government agrees with the recommendation. These changes will help ensure clients actively consider whether they are benefiting from ongoing fee arrangements.

Additional commentary

The Commissioner takes issue with current ongoing service arrangements, as 'services to be provided under those arrangements were so loosely defined that they had little or no substantive content beyond a promise to speak to the client (sometimes an *offer* to speak to the client) once each year' (Volume 1, page 136). The mere offer of a review is insufficient to justify a service fee (Volume 1, page 143). References are drawn to [section 1041G](#) of the *Corporations Act 2001* (in relation to dishonest conduct) as fees were charged without any proper basis (Volume 1, pages 154-155). Inadequate systems also lead to this conduct – but are not the

only cause (Volume 1, page 159). There is concern over the 'invisible' nature of fee payments made directly from investments (Volume 1, pages 162-163).

TechConnect comment

This means forward-looking fee disclosure statements with opt-in fee arrangements each year and with no grandfathering. Ongoing service agreements need to be clear and measurable and systems will be required to track what was actually delivered and to compare it to what was promised. The obligation on providers to not pay fees unless specifically authorised each year will require system changes to automatically turn off fees from products if they are not re-authorised. Legislation will specify what constitutes 'express written authority'.

2.2 Disclosure of lack of independence

Royal Commission's recommendation

The law should be amended to require that a financial adviser who *would* contravene [section 923A](#) of the *Corporations Act 2001* (relating to the restriction on use of certain words or expressions) by assuming or using any of the restricted words or expressions identified in section 923A(5) (including 'independent' 'impartial' and 'unbiased') must, before providing personal advice to a retail client, give to the client a written statement (in, or to the effect of, a form to be prescribed) explaining simply and concisely *why* the adviser is not independent, impartial and unbiased.

Government response

The Government agrees with the recommendation.

Additional commentary

At the core of this issue is the Commissioner's view on the inherent conflict of duty (to client) and (self) interest (Volume 1, pages 165-166). Future of Financial Advice (FoFA) reforms 'emphasise process rather than outcome' (Volume 1, page 167). Conflicts are currently disclosed in the financial services guide (FSG). The Commissioner references the United Kingdom's (UK) financial advisory system which has 'independent' and 'restricted' advisers. In this system, restricted advisers have to disclose their limitations and conflicts separately and explicitly (Volume 1, pages, 173-174). There is a need to bring the conflicts to the forefront of disclosure, and also explain *why* the conflict exists (Volume 1, page 176).

TechConnect comment

This means an additional separate disclosure to the FSG, is likely to be required before entering into any advisory agreement. The level of detail is not specified in the report, beyond explaining 'prominently, clearly and concisely why the adviser is not considered 'independent' under section 923A of the *Corporations Act 2001*' (Volume 1, page 176).

2.3 Review of measures to improve the quality of advice

Royal Commission's recommendation

In three years' time, there should be a review by the Government in consultation with ASIC of the effectiveness of the measures that have been implemented by the Government, regulators and financial services entities to improve the quality of financial advice. The review should preferably be completed by 30 June 2022, but no later than 31 December 2022.

Among other things, that review should consider whether it is necessary to retain the 'safe harbour' provision in [section 961B\(2\)](#) of the *Corporations Act 2001* (that is, the best interests duty). Unless there is a clear justification for retaining that provision, it should be repealed.

Government response

The Government agrees with the review. It further agrees that it is appropriate to undertake the review following the implementation of the recently legislated [Financial Adviser Standards and Ethics Authority](#) (FASEA) requirements plus the [target market legislation](#) which is currently before the Parliament.

Additional commentary

'...given that the present safe harbour model does not prevent interest from trumping duty, altering the model is unlikely to work' (Volume 1, page 177). The Commissioner is concerned about a 'tick box' culture the safe harbour provisions has introduced, versus the amount of change financial advisers face where a safe harbour is appropriate (Volume 1, page 177).

TechConnect comment

There will be a greater focus by licensees on the quality of advice prior to the review. A poor outcome could result in reputational risk for both the entity and the industry. The review in three years' time will likely reveal that more change is required to increase the quality of advice.

2.4 Grandfathered commissions

Royal Commission's recommendation

Grandfathering provisions for conflicted remuneration should be repealed as soon as is reasonably practicable.

Government response

The Government agrees to end grandfathered commissions by 1 January 2021. Any conflicted remuneration received after that date will have to be rebated back to clients. Volume-based rebates are expected to be reflected in lower fees for all impacted clients. ASIC will monitor and report on implementation of change from 1 July 2019 to 1 January 2021. This measure was supported by the Productivity Commission's report.

Additional commentary

'Each of the major banks has already announced steps to reduce or eliminate payments of grandfathered commissions in their financial advice businesses' (Volume 1, page 183). Submissions from many parties were to the same effect. 'It is time to ignore the ghostly apparition of constitutional challenge conjured forth by those who, for their own financial advantage, oppose change that will bring free advice about, or recommendation of, financial products from the influence of the adviser's personal financial advantage' (Volume 1, page 18).

TechConnect comment

Advisers will need to consider the impact on their business including its remuneration structure and valuations, if not done so already. There is a potential contention around the date to end grandfathered commissions if Labor is elected – it's unlikely to be brought forward to any earlier than 1 July 2020.

2.5 Life risk insurance commissions

Royal Commission's recommendation

Where ASIC conducts its review of conflicted remuneration related to life risk insurance products and the operation of the [ASIC Corporations \(Life Insurance Commissions\) Instrument 2017/510](#), ASIC should consider further reducing the cap on commissions in respect of life risk insurance products. Unless there is a clear justification for retaining those commissions, the cap should ultimately be reduced to zero.

Government response

The Government supports this recommendation. ASIC was already scheduled to complete its review of 2017 life insurance arrangements in 2021, so this will form part of that process.

Additional commentary

'I doubt that a complete ban on conflicted remuneration in respect of life insurance products would lead to significant underinsurance' however ASIC can use the reductions in commissions that are currently scheduled to occur over the next few years to confirm whether underinsurance is likely (Volume 1, page 188).

TechConnect comment

Advisers need to consider their value proposition for insurance advice and how this would fit into a fee-only world in three years' time. This will also affect advice business valuations.

2.6 General insurance and consumer credit insurance commissions

Royal Commission's recommendation

The review in three years' time on the quality of advice, referred to in Recommendation 2.3 (Volume 1, page 26) should also consider whether each remaining exemption to the ban on conflicted remuneration remains justified, including:

- the exemptions for general insurance products and consumer credit insurance products
- the exemptions for non-monetary benefits set out in [section 963C Corporations Act 2001](#), such as the genuine education or training exemptions and the \$300 exemptions.

Government response

The Government agrees to the review of the general insurance exemption in three years' time.

Additional commentary

'By the time of the review referred to in Recommendation 2.3, these exemptions from the ban on conflicted remuneration will have been in place for almost 10 years' (Volume 1, page 189).

TechConnect comment

This does not raise any immediate concern. However, it will be interesting to see how services such as technical support would fit in a world where non-monetary benefits are considered conflicted remuneration.

2.7 Reference checking and information sharing

Royal Commission's recommendation

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

Government response

The Government agrees with mandating reference-checking protocol.

Additional commentary

Licensees do not communicate enough between each other, and when communication does occur it is generally lacking (Volume 1, page 199).

TechConnect comment

The protocol contains a series of questions a licensee should ask prospective advisers to assist with 'weeding out' those advisers who are moving between licensees in order to avoid negative compliance outcomes.

2.8 Reporting compliance concerns

Royal Commission's recommendation

All AFSL holders should be required, as a condition of their licence, to report 'serious compliance concerns' about individual financial advisers to ASIC on a quarterly basis.

Government response

The Government agrees to mandate reporting of 'serious compliance concerns'.

Additional commentary

Late reporting is impeding ASIC's ability to regulate financial advice (Volume 1 page 203). 'Serious compliance concerns are where the licensee believes and has some credible information in support of the concerns identified that a financial adviser may have engaged in dishonest, illegal, deceptive and/or fraudulent misconduct or any misconduct that, if proven, would be likely to result in an instant dismissal or immediate termination; or deliberate non-compliance with financial services laws or gross incompetence or gross negligence' (Volume 1, page 204). There will be a need to differentiate between licensee concerns and adviser-specific concerns (Volume 1, page 204).

TechConnect comment

There will be a greater focus by licensees and advisers regarding compliance and reporting. Advisers may seek greater assistance and protection from their licensees to ensure compliance.

2.9 Misconduct by financial advisers

Royal Commission's recommendation

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

- Make whatever enquiries are reasonably necessary to determine the nature and full extent of the adviser's misconduct.
- Where there is sufficient information to suggest that an adviser has engaged in misconduct, tell affected clients and remediate those clients promptly.

Government response

The Government agrees with the AFSL condition. The recommendation is in line with increased ASIC powers as part of the ASIC Enforcement Review.

Additional commentary

'The evidence also showed that, too often, bad audit results had no, or no significant, consequences for the adviser' (Volume 1, page 201). 'When an entity detects that an adviser has engaged in misconduct (whether by giving inappropriate advice or otherwise), it should always consider what steps it should take to see whether the adviser may have acted poorly in respect of matters other than those that are the immediate focus of attention' (Volume 1, page 205).

TechConnect comment

This recommendation places additional requirements on dealer groups to not only monitor advisers, but to also identify and fully investigate issues.

2.10 A new disciplinary system

Royal Commission's recommendation

The law should be amended to establish a new disciplinary system for financial advisers that:

- requires all financial advisers who provide personal financial advice to retail clients to be registered
- provides for a single, central, disciplinary body
- requires AFSL holders to report 'serious compliance concerns' to the disciplinary body
- allows clients and other stakeholders to report information about the conduct of financial advisers to the disciplinary body.

Government response

The Government agrees to introduce a new system. Individual registration is aligned with other professions.

Additional commentary

'One hallmark of a profession is the existence of a credible and coherent system of professional discipline – the ultimate sanction available to be imposed under that system being expulsion from the profession' (Volume 1, page 199). The Financial Planning Association of Australia (FPA) and the Association of Financial Advisers Ltd (AFA) do not currently play a significant role in enforcing proper standards (Volume 1, page 208). The Commissioner's view on the new approach to discipline can be found in Volume 1, pages 212-217. The key tenets are mandatory individual registration (tied to the ability to give financial advice), with disciplinary powers, mandatory notification obligations on licensees for specific breaches and voluntary notifications for other issues (available to licensees, industry bodies and clients of advisers). This would not change existing AFSL obligations but enhance them (Volume 1, page 214).

TechConnect comment

This will place more individual responsibility on advisers. Dealer groups will also now have a new stakeholder to inform regarding individual adviser actions separate to any AFSL concerns. This has the potential to increase costs to dealer groups and advisers depending on the funding model. No timeframe has been proposed at this time.

Superannuation

The majority of recommendations covering super relate to higher accountability and greater penalties for trustees who breach their duties and limiting the amount of fees that can be deducted from accounts.

3.1 - No other role or office

Royal Commission's recommendation

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. (Volume 1, page 229).

Government response

The Government agrees to address the risks associated with dual regulated entities.

Additional commentary

The Final Report suggests that conflicts arise when a 'trustee tries to wear two hats'. However, it is also noted that an RSE licensee may be the trustee of more than one superannuation fund. (Volume 1, page 228).

TechConnect comment

This recommendation will assist with the transparency of complying with the best interests duty. Super funds will need to review their trustee structures and functions.

Advice fees deducted from superannuation accounts

The Royal Commission made its view clear on the deduction of advice fees from superannuation accounts and the sole purpose test. The deduction of advice fees (including ongoing advice fees) for the provision of broad advice, for example, how the client should order their financial affairs, maximise their wealth generally and provide for post-retirement income, 'must end'.

The provision of such broad advice is not consistent with the sole purpose test. A trustee of a superannuation fund must ensure the fund is maintained solely for the specified purposes which is to provide benefits upon a member's death or retirement.

Consequently, the nature of advice fees that may be deducted from superannuation accounts is limited to advice about particular, or intended, superannuation investments. Fees which may be deducted from superannuation accounts include advice in relation to:

- consolidation of superannuation accounts
- selection of superannuation funds and products
- asset allocations within a fund.

This general rule for advice fees deducted from superannuation accounts is modified for MySuper accounts (Recommendation 3.2) and ongoing fees (Recommendation 3.3) (Volume 1, pages 241 and 243).

Given the sole purpose test in section 62 of [Superannuation Industry \(Supervision\) Act 1993](#) (SISA) limits the nature of advice fees that may be deducted from superannuation accounts, in the Royal Commission's view, no legislative amendment is necessary (Volume1, page 239).

TechConnect comment

Advice fees for matters outside the scope of limited advice on particular, actual or intended superannuation investments should not be deducted from superannuation and pension accounts. Where fees for limited advice is permissibly deducted from superannuation and pension accounts, the subject matter of the advice should be clearly defined.

3.2 - No deducting advice fees from MySuper accounts

Royal Commission's recommendation

'Deduction of any advice fee (other than for intra-fund advice) from a MySuper account should be prohibited'. (Volume 1, page 241).

Government response

The Government agrees with this recommendation.

Additional commentary

The Final Report suggests it would be 'difficult to imagine circumstances in which a member would require financial advice about their MySuper account'. The Final Report goes on to say that 'if a member wants financial advice, the cost of that advice should be charged to and paid by the member directly'. (Volume 1, page 240).

TechConnect comment

This will mean a total prohibition of all types of advice fees deducted from MySuper accounts which will simplify the arrangements for MySuper members. This includes a prohibition on limited advice on particular, actual or intended superannuation investments. Advice to MySuper members will need to be charged to and paid by the member directly.

3.3 - Limitations on deducting advice fees from choice accounts

Royal Commission's recommendation

The 'deduction of any advice fee (other than for intra-fund advice) from superannuation accounts other than MySuper accounts should be prohibited unless the reporting requirements about annual renewal, prior written identification of service and provision of the client's express written authority set out in Recommendation 2.1, in connection with ongoing fee arrangements are met' (Volume 1, page 243).

Government response

The Government agrees with this recommendation.

Additional commentary

The Final Report emphasises that this recommendation does not relate to intra-fund advice (Volume 1, page 242).

TechConnect comment

Rather than a total prohibition, ongoing advice fees should be tightly controlled by limiting advice to particular, actual or intended superannuation investments (a sole purpose test restriction) and the new requirement for annual renewal of ongoing advice arrangements (Recommendation 2.1, Volume 1, page 164).

3.4 - No hawking

Royal Commission's recommendation

The unsolicited offer or sale of superannuation products should be prohibited. Further, the definition of hawking should be clarified to include the offering of a superannuation product during a meeting, call or other contact initiated by the client to discuss an unrelated financial product (Volume 1, page 250).

Government response

The Government agrees with this recommendation.

Additional commentary

The Final Report stresses it is unlikely that the unsolicited offer of a superannuation product is appropriate or in the interests of consumers. The Final Report also mentions that attempts by ANZ and CBA to sell superannuation in bank branches under a 'general advice' model may have contravened the law. (Volume 1, pages 248-249).

TechConnect comment

This recommendation is intended to stop the poor practice of selling unsuitable superannuation products to people.

Superannuation products should not be offered to clients who initiate contact for the purposes of discussing another type of product. Superannuation and insurance products should be treated as distinct product types. A question arises as to whether a superannuation product may be offered to a client who initiates contact for the purpose of an insurance product on the basis that both products are related.

This recommendation will have a limited impact on employer super and MySuper products.

3.5 - One default account

Royal Commission's recommendation

A person should have only one default account (Volume 1, page 253).

Government response

The Government agrees that a person should have only one default account and believes this builds on their previous work of reducing multiple accounts.

Additional commentary

Default superannuation accounts should only be created for new workers, or workers who do not already have a superannuation account¹. This default account should then be carried over, or 'stapled', to super members as they move jobs. The proliferation of unnecessary default accounts is not in the interests of members.

TechConnect comment

This recommendation will reduce the instance of multiple default super accounts and has the potential to assist members engage more with their super. The implementation of this recommendation could be included as an extension of the 'Protecting Your Super' package.

3.6 – No treating of employers

Royal Commission's recommendation

Trustees should be prohibited from undertaking actions, including supplying goods or services, that have a substantial purpose of having the employer nominate the trustees' fund as a default fund (Volume 1, page 30 and page 253).

Government response

The Government agrees to amend superannuation law to implement this recommendation.

Additional commentary

The Final Report notes that trustees should not be permitted to attempt to influence employers' decisions through irrelevant considerations (Volume 1, page 252). The current provision of SISA (section 68A) is ineffective in curtailing practices of some funds in supplying entertainment or tickets to sporting events in connection with one or more employees becoming members of the fund.

¹ Productivity Commission, Report 91, *Superannuation: Assessing Efficiency and Competitiveness*, 21 December 2018, 65.

TechConnect comment

It will be interesting to see how this is policed and if there is any extension to the ongoing supply of goods or services that are intended to encourage an employer to retain a trustee's default fund.

3.7 - Breach of covenants

Royal Commission's recommendation

Trustees should be subject to civil penalties for breaches of the trustee covenants and MySuper obligations (Volume 1, page 261).

Government response

The Government agrees that trustees and directors should be subject to civil penalties for breaches of their best interests duty and that APRA and ASIC should have powers to enforce civil penalty provisions. Amendments will be made to the existing Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No.1) Bill 2017.

Additional commentary

The Final Report assumes that ASIC would be the agency (rather than APRA) that would take any enforcement action (Volume 1, page 262).

TechConnect comment

This recommendation is another example of ensuring trustees are accountable to members. We expect a greater emphasis will be placed on compliance, risks and controls.

Insurance in superannuation

A number of recommendations have been made regarding insurance in super which are designed to enhance consumer experiences.

4.13 – Universal terms

Royal Commission's recommendation

The Government should consider legislating universal key definitions, terms and exclusions for default MySuper group life policies (Volume 1, page 34).

Government response

The Government agrees with this recommendation.

Additional commentary

The Final Report observes that insurance within MySuper is default insurance and the value of a policy heavily relies on key definitions, terms and exclusions, therefore suggesting there is merit in standardisation (Volume 1, page 323).

4.14 – Related party insurance

Trustees who use related party insurers should be required to provide independent certification to APRA that the insurance arrangements are in the best interests of members (Volume 1, page 328).

Government response

The Government supports APRA acting on this recommendation.

Additional commentary

The Final Report suggests that when there are related party engagements that RSE licenses 'obtain a report from an appropriately independent and qualified firm certifying that the engagement is in the best interests of members and otherwise satisfies legal and regulatory requirements' (Volume 1, page 328).

TechConnect comment

This is another recommendation which is intended to improve the transparency of the best interests duty. Like many insurance products, it will be important to ensure that best interest is determined on a range of factors, including service, and not on price alone. This recommendation is also likely to increase compliance costs.

4.15 - Status attribution to be fair and reasonable

Royal Commission's recommendation

APRA should require RSE licensees to be satisfied that the rules by which a particular status is attributed to a member in connection with their insurance is fair and reasonable (Volume 1, page 330).

Government response

The Government supports APRA acting on this recommendation.

Additional commentary

The Final Report raised concerns that some trustees were automatically classifying members as a 'smoker' or a 'blue-collar worker' unless they received specific information from the member to the contrary (Volume 1, page 330).

TechConnect comment

This recommendation may require further information from employers on a timely basis. The extension of single touch payroll may assist in achieving this recommendation. Processes, disclosure and/or premium pricing are likely to be impacted.

Regulatory and governance

5.1 - Supervision of remuneration - principles, standards and guidance

Royal Commission's recommendation

'In conducting prudential supervision of the design and implementation of remuneration systems, and revising its prudential standards and guidance about remuneration, APRA should have, as one of its aims, the sound management by APRA-regulated institutions of not only financial risk but also misconduct, compliance and other non-financial risks' (Volume 1, page 367).

Government response

The Government supports APRA acting on this recommendation.

Additional commentary

APRA should consider how it can require and encourage APRA-regulated institutions to improve the quality of the information they supply to APRA when it updates its prudential standards and guidance in relation to remuneration (Volume 1, page 361).

5.3 - Revised prudential standards and guidance

Royal Commission's recommendation

'In revising its prudential standards and guidance about the design and implementation of remuneration systems, APRA should:

- require APRA-regulated institutions to design their remuneration systems to encourage sound management of non-financial risks, and to reduce the risk of misconduct;
- require the board of an APRA-regulated institution (whether through its remuneration committee or otherwise) to make regular assessments of the effectiveness of the remuneration system in encouraging sound management of non-financial risks, and reducing the risk of misconduct;
- set limits on the use of financial metrics in connection with long-term variable remuneration;
- require APRA-regulated institutions to provide for the entity, in appropriate circumstances, to claw back remuneration that has vested; and
- encourage APRA-regulated institutions to improve the quality of information being provided to boards and their committees about risk management performance and remuneration decisions' (Volume 1, page 367).

Government response

The Government supports APRA acting on this recommendation.

Additional commentary

The Final Report noted that in the past APRA lacked the confidence to monitor remuneration practises and stresses that APRA will need to address this. It stated, 'It is to be hoped that, following its more recent work in the Prudential Inquiry, and its review of remuneration practices at large financial institutions, APRA does now have the confidence and expertise that Mr Byres felt it lacked in 2016. If it does not, APRA should seek to develop that confidence and expertise as quickly as possible' (Volume 1, page 365).

5.4 – Remuneration of front line staff

Royal Commission's recommendation

'All financial services entities should review at least once each year the design and implementation of their remuneration systems for front line staff to ensure that the design and implementation of those systems focus on not only what staff do, but also how they do it' (Volume 1, page 375).

Government response

The Government supports all financial services entities acting on this recommendation.

Additional commentary

'Poorly designed and implemented remuneration arrangements can increase the risk of misconduct. Well designed and implemented remuneration arrangements can play an important role in reducing that risk' (Volume 1, page 346).

5.6 – Changing culture and governance**Royal Commission's recommendation**

'All financial services entities should, as often as reasonably possible, take proper steps to:

- assess the entity's culture and its governance
- identify any problems with that culture and governance
- deal with those problems
- determine whether the changes it has made have been effective' (Volume 1, page 392).

Government response

The Government supports financial entities acting on this recommendation.

Additional commentary

'To ignore the recommendation would be foolish and ignorant. It would be foolish because one of the chief lessons financial services entities must take from the work of this Commission is that every entity is and must be accountable for what it does. It would be ignorant because those who will not learn from history will repeat it' (Volume 1, page 392).

TechConnect comment

Our ClientFirst philosophy, demonstrates how we have made progress in relation to culture, however, a wider review would likely be required.

5.7 – Supervision of culture and governance**Royal Commission's recommendation**

'In conducting its prudential supervision of APRA-regulated institutions and in revising its prudential standards and guidance, APRA should:

- build a supervisory program focused on building culture that will mitigate the 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' (Volume 1, page 393).

Government response

The Government supports APRA acting on this recommendation.

Additional commentary

The Final Report refers to the FSB's publication ['Strengthening Governance Frameworks to Mitigate Misconduct Risks: A Toolkit for Firms and Supervisors'](#). The Toolkit states that supervisors should adopt the steps recommended to APRA (Volume 1, page 387).

'This particular recommendation requires entities to take all that is set out in this Report, including all the other recommendations that are made, and apply, re-apply, and keep re-applying what is said to their culture and their governance' (Volume 1, page 393).

6.1 - Retain twin peaks

Royal Commission's recommendation

'The 'twin peaks' model of financial regulation, where responsibility for conduct and disclosure regulation lies primarily with ASIC and responsibility for prudential regulation with APRA, should be retained' (Volume 1, page 423)

Government response

The Government agrees with this recommendation.

6.2 - ASIC's approach to enforcement

Royal Commission's recommendation

'ASIC should adopt an approach to enforcement that:

- takes, as its starting point, the question of whether a court should determine the consequences of a contravention;
- recognises that infringement notices should principally be used in respect of administrative failings by entities, will rarely be appropriate for provisions that require an evaluative judgment and, beyond purely administrative failings, will rarely be an appropriate enforcement tool where the infringing party is a large corporation;
- recognises the relevance and importance of general and specific deterrence in deciding whether to accept an enforceable undertaking and the utility in obtaining admissions in enforceable undertakings; and
- separates, as much as possible, enforcement staff from non-enforcement related contact with regulated entities' (Volume 1, page 446).

Government response

The Government supports this recommendation and noted that changes are underway within ASIC, with its recent shift towards litigation. In addition, changes are already underway in relation to its policies, processes and procedures following a recent internal review of enforcement.

Additional commentary

ASIC stated that it 'recognises that its enforcement priorities must change to emphasise deterrence and public denunciation more strongly in its use of various regulatory tools (inside and, where applicable, outside court) as mechanisms by which to change behaviours' (Volume 1, page 425).

6.3 - General principles for co-regulation

Royal Commission's recommendation

'The roles of APRA and ASIC in relation to superannuation should be adjusted to accord with the general principles that:

- APRA, as the prudential regulator for superannuation, is responsible for establishing and enforcing Prudential Standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by superannuation entities APRA supervises are met within a stable, efficient and competitive financial system; and
- as the conduct and disclosure regulator, ASIC's role in superannuation primarily concerns the relationship between RSE licensees and individual consumers.

Effect should be given to these principles by taking the steps described in recommendations 6.4 and 6.5' (Volume 1, page 453).

6.4 - ASIC as conduct regulator

Royal Commission's recommendation

'Without limiting any powers APRA currently has under the SIS Act, ASIC should be given the power to enforce all provisions in the SIS Act that are, or will become, civil penalty provisions or otherwise give rise to a cause of action against an RSE licensee or director for conduct that may harm a consumer. There should be co-regulation by APRA and ASIC of these provisions' (Volume 1, page 455).

6.5 - APRA to retain functions

Royal Commission's recommendation

'APRA should retain its current functions, including responsibility for the licensing and supervision of RSE licensees and the powers and functions that come with it, including any power to issue directions that APRA presently has or is to be given' (Volume 1, page 455).

Government response to 6.3, 6.4 and 6.5

The Government agrees that the roles of APRA and ASIC in superannuation should be adjusted to align with the general principles of the twin peaks model, whereby APRA is the prudential regulator and responsible for system and fund performance, including for licencing and supervision, and ASIC is the conduct and disclosure regulator.

The Government agrees that both ASIC and APRA should have stronger powers to enforce provisions that are civil penalty provisions and other provisions relating to conduct that may harm a consumer.

Regulators' responsibilities under SISA will be shared in a way that aligns with ASIC's and APRA's mandates.

Additional commentary

The Final Report is satisfied that the two regulators are adequate and that it is not necessary for a separate regulator for the superannuation sector (Volume 1, page 451). However, ASIC may be more effective if it was provided with greater power to protect the interests of members. The Final Report also notes that 'enforcement is a fundamental aspect of ASIC's work'.

The Government noted in its response that they will consider what additional funding is required in the 2019/20 Federal budget context.

On 19 October 2016, a Taskforce to conduct a review of ASIC's enforcement regime to determine the adequacy of, among other things: the civil and criminal penalties for serious contraventions relating to the financial system. It made 50 recommendations including giving ASIC a new directions power (Volume 1 page 419).

TechConnect comment

ASIC will have its civil penalty provisions enhanced. Companies will have greater scrutiny from the regulators.

6.9 – Statutory obligation to co-operate

Royal Commission's recommendation

'The law should 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' (Volume 1, page 464).

Government response

The Government agrees to remove barriers to information sharing and to notify each other of relevant breaches or suspected breaches.

6.10 – Co-operation memorandum

Royal Commission's recommendation

'ASIC and APRA should prepare and maintain a joint memorandum setting out how they intend to comply with their statutory obligation to co-operate. The memorandum should 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' (Volume 1, page 464).

Government response

The Government supports ASIC and APRA continuing to work together to update their existing memorandum of understanding.

7.1 - Compensation scheme of last resort

Royal Commission's recommendation

'The three principal recommendations to establish a compensation scheme of last resort made by the panel appointed by government to review external dispute and complaints arrangements made in its supplementary final report should be carried into effect' (Volume 1, page 487).

Government response

The Government agrees to establish an industry-funded, forward-looking compensation scheme of last resort (CSLR). The scheme will be designed consistently with the recommendations of the [Supplementary Final Report](#) of the review of the financial system external dispute resolution framework (Ramsay Review) and will extend beyond disputes in relation to personal financial advice failures.

For there to be confidence in the financial system's dispute resolution framework, it is important that where consumers and small businesses have suffered detriment due to failures by financial firms to meet their obligations, compensation that is awarded is actually paid. The CSLR will operate as a last resort mechanism to pay out compensation owed to consumers and small businesses that receive a court or tribunal decision in their favour or a determination from the Australian Financial Complaints Authority (AFCA) but are unable to get the compensation owed by the financial firm because, for example, the firm has become insolvent.

The CSLR will be established as part of AFCA.

The Government also agrees to fund the payment of legacy unpaid determinations from the Financial Ombudsman Service and Credit and Investments Ombudsman. The Ramsay Review found that there was a strong case for these determinations to be paid.

Additional commentary

The Government agrees with the Ramsay Review's recommendations in this area (Volume 1, pages 481-486).

TechConnect comment

This recommendation could potentially increase costs for financial services entities in relation to compensation claims.

7.3 – Exceptions and qualifications

Royal Commission's recommendation

'As far as possible, exceptions and qualifications to generally applicable norms of conduct in legislation governing financial services entities should be eliminated' (Volume 1, 496).

Government response

The Government agrees to simplify the financial services law to eliminate exceptions and qualifications to the law, where possible. The Government also agrees to identify the norms of behaviour and principles that underpin legislation as part of the legislative simplification process.

Additional commentary

'Industry, community groups and regulators agreed the current law is too complex. Eliminating exceptions and qualifications is the first step towards a simpler and more readily understood body of law' (Volume 1, page 494).

TechConnect comment

This recommendation may simplify financial services law but at the cost of potentially losing some carve outs, such as general insurance and basic banking products.

7.4 – Fundamental norms

Royal Commission's recommendation

'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' (Volume 1, page 496).

Government response

The Government agrees to identify the norms of behaviour and principles that underpin legislation as part of the legislative simplification process.

Additional commentary

The Government also references the Royal Commission observation that over-prescription and excessive detail can shift responsibility for behaviour away from regulated entities and encourage them to undertake a 'box-ticking' approach to compliance.

'The second step is... to identify expressly what fundamental norms of behaviour are being pursued when particular and detailed rules are made about a given subject... further consequence of identifying the basic norms to which the detailed rules are intended to give effect, would be that any continued exceptions and carve outs would stand in sharp relief' (Volume 1, page 494).

Vertical integration

Royal Commission's recommendation

There is no specific recommendation in respect of vertical integration, however, the report recommends reviewing the effects of vertical and horizontal integration in the financial system.

Government response

The Government agrees that it is important to understand the longer-term market implications of integration and supports the Australian Competition and Consumer Commission (ACCC) consideration of integration issues as part of its market studies work. The Productivity Commission's report '[Competition in the Australian Financial System](#)' recommended that the ACCC should undertake five-yearly market studies on the effect of vertical and horizontal integration on the financial system.

Additional commentary

'Enforced separation of product and advice would be a very large step to take. It would be both costly and disruptive. I cannot say that the benefits of requiring separation would outweigh the costs, and the Productivity Commission concluded that 'forced structural separation is not likely to prove an effective regulatory response to competition concerns in the financial system'. I observe, however, that the Productivity Commission recommended, and I agree, that commencing in 2019, the ACCC 'should undertake 5 yearly market studies on the effect of vertical and horizontal integration in the financial system.

I am not persuaded that it is necessary to mandate structural separation between product and advice' (Volume 1, page 196).

The history of vertical integration and the Wallis Inquiry were also considered (Volume 1, pages 124-126).

A significant discussion as to the challenges of vertical integration and consideration as to the product manufacturers exiting the financial advice business (Volume 1, pages 190-194).

ASIC's report 562 '[Financial Advice: Vertically Integrated Institutions and Conflicts of Interest](#)' shows just how much advice relates to close-party products (Volume 1, pages 168-169).

Vertical integration should provide the most resources to manage conflicts of interest, however, this is not what the Commissioner has observed (Volume 1, pages 178-179).

TechConnect comment

The impact of vertical integration will still come under consideration by the ACCC. There is no immediate impact.

Other

1.15 and 4.9 – Enforceable code provisions

Royal Commission's recommendation

Legislation should be amended to extend ASIC's power to approve codes of conduct and allow them to contain 'enforceable code provisions', a contravention of which will constitute a breach of the law.

The codes impacting super include the Financial Services Council, the Insurance Council of Australia and the Superannuation Voluntary Code.

'The law should be amended to provide:

- that ASIC's power to approve codes of conduct extends to codes relating to all APRA-regulated institutions and Australian Credit Licence (ACL) holders;
- that industry codes of conduct approved by ASIC may include 'enforceable code provisions', which are provisions in respect of which a contravention will constitute a breach of the law;
- that ASIC may take into consideration whether particular provisions of an industry code of conduct have been designated as 'enforceable code provisions' in determining whether to approve a code;
- for remedies, modelled on those now set out in Part VI of the *Competition and Consumer Act*, for breach of an 'enforceable code provision'; and for the establishment and imposition of mandatory financial services industry codes' (Volume 1, page 112).

Government response

The Government agrees to amend the law to provide ASIC with additional powers to approve and enforce industry codes. The Government supports the relevant code bodies and ASIC acting on the recommendation.

Additional commentary

It is considered important that some provisions of industry codes be picked up and applied as law, so that breaches of those provisions will constitute a breach of the law. The provisions to be picked up and applied are those that govern the terms of the contract made or to be made between the financial services entity and the customer or a guarantor. There is a need to create certainty as to what extent the various codes are legally-binding (Volume 1, pages 104-105).

The Final Report notes that 'ASIC can and should encourage industry to develop the ideas that are to be reflected in the enforceable code provisions and should more broadly continue to engage with industry about its codes' (Volume 1, page 108).

TechConnect comment

Compliance with codes of practice have not always been universally adopted and this measure will further enhance the integrity of the financial services sector. Further importance will be placed not only on forming industry codes, but also ASIC's consideration of the codes. Businesses will need to review their practices in line with new and enforceable codes. This may require expenditure on new processes, support and monitoring.

4.11 – Co-operation with AFCA

Royal Commission's recommendation

Legislation should be amended to require that AFSL holders take reasonable steps to co-operate with the AFCA in its resolution of disputes, including, by making available to AFCA all relevant documents and records relating to issues in dispute (Volume 1, page 318).

Government response

The Government agrees to place an obligation on AFSL holders to take reasonable steps to co-operate with AFCA.

Additional commentary

The Final Report noted that this proposal will make AFSL holders more accountable to AFCA, the external dispute resolution body (Volume 1, page 317). This issue was originally raised in relation to insurance claims complaints case studies, however, the Commissioner does not see any issue with broader application to all AFSLs (Volume 1, page 317).

TechConnect comment

Further resources for both dealer groups and product providers may be required to assist in dealing with external complaints in the future because records may not be easily or centrally accessible.

Life insurance

4.5 Duty to take reasonable care not to make a misrepresentation to an insurer

Royal Commission's recommendation

'[Part IV](#) (regarding disclosures and misrepresentations) of the *Insurance Contracts Act 1984* should be amended, for consumer insurance contracts, to replace the duty of disclosure with a duty to take reasonable care not to make a misrepresentation to an insurer (and to make any necessary consequential amendments to the remedial provisions contained in Division 3)' (Volume 1, page 302).

Government response

The Government agrees with the recommendation.

Additional commentary

'In my view, the duty of disclosure presently...does not recognize the breadth and depth of the gap between what a consumer knows and what an insurer knows' (Volume 1, page 297). This follows a similar review that took place in the UK in relation to this issue (Volume 1, page 299).

TechConnect comment

This will provide an increased level of protection for consumers entering into contracts with parties who have substantially more power than the client.

4.6 Avoidance of life insurance contracts

Royal Commission's recommendation

'[Section 29](#) (3) of the *Insurance Contracts Act 1984* should be amended so that an insurer may only avoid a contract of life insurance on the basis of non-disclosure or misrepresentation if it can show that it would not have entered into the contract on any terms' (Volume 1, page 303).

Government response

The Government agrees with recommendation.

Additional commentary

This is framed as a restoration of the pre-2013 amendment changes to stop insurers avoiding contracts they would have entered into on any terms, rather than the exact same terms as the cover that was offered.

TechConnect comment

This will restore consumer protection and reduce an insurer's ability to avoid claims.

4.7 Application of unfair contract terms

Royal Commission's recommendation

'The unfair contract terms provisions now set out in the *ASIC Act 2001* should apply to insurance contracts regulated by the *Insurance Contracts Act 1984*. The provisions should be amended to provide a definition of the 'main subject matter' of an insurance contract as the terms of the contract that describe what is being insured.'

The duty of utmost good faith contained in [section 13 of the *Insurance Contracts Act 1984*](#) should operate independently of the unfair contract terms provisions' (Volume 1, page 308).

Government response

The Government agrees with the recommendation.

TechConnect comment

This recommendation will create further consumer protection for insurance contracts.