The Financial Services Royal Commission: quo vadis, Financial Services Industry? Part 2 — advice, life insurance and general matters

Background

Part 1 of this article dealt with the implications for superannuation and vertical integration arising from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission).

Commissioner Kenneth Hayne submitted an interim report[1] to the Governor-General on 28 September 2018, with the report being tabled in parliament on the same date. The interim report provided some indication as to the direction the final report might take and the thinking of the Royal Commission on a range of topics canvassed before it.

On 1 February 2019, the Commissioner submitted that final report[2] (Report) to the Governor-General. The Report was tabled in parliament on 4 February 2019. The government and the opposition each issued supportive responses to the Report.

Purpose

The purpose of this article is to discuss some of the implications of the Report for the advice and life insurance[3] sectors of the financial services industry and the potential challenges it presents. In addition, some comment will be made on more general matters, including a revised focus by the Australian Prudential Regulation Authority (APRA) on culture, governance and remuneration and regulatory approaches. As mentioned in Part 1 of this article, with some 76 recommendations, it is not possible to analyse in minute detail the recommendations. This article does not focus on recommendations which are specific to the banking and general insurance industries. Rather, again, my purpose is to draw out some undercurrents in the Report with a view to commenting on where indeed the financial services industry is going and what we can expect to see in terms of legislative and administrative change.[4]

Despite some criticisms of the Report for "not going far enough", in my view there are some potentially wide-ranging implications of the Report. I will note these in this article where appropriate.

Caveat

A note of caution — the final political and legislative outcomes of the Report are unclear. On 11 April 2019, the parliament was prorogued until 18 May 2019 (with a Commonwealth election called for 18 May 2019).

There appears to have been some divergence by the government, in the sense explained below — some of the recommendations and the implementation timetable proposed by the government and the opposition differ; and there are also some differences in the accepted substantive content of the proposed reforms.[5]

The Treasury has several open consultations at the time of writing, in relation to the implementation of a number of the Royal Commission recommendations.

2019–20 Commonwealth Budget

The Treasurer released the Budget on 2 April 2019. One of the topics of the overview documents was *Guaranteeing Essentials Services*.[7] Included within that paper is a discussion headed "Restoring trust in Australia's financial system".[8] This summarises the measures the government is taking in response to the 76 recommendations of the Royal Commission.

Action already taken by government

The paper goes on to note that the government has taken the following steps:

- enhancing consumer protection:
  - — released draft legislation to end grandfathered conflicted remuneration to financial advisers
  - — passed legislation in the Senate to strengthen the superannuation regulatory framework
- effective financial regulators:
  - — APRA's capability review is underway[9]
  - — $35.5 million to expand the Federal Court by the creation of a new criminal jurisdiction
  - — more than $550 million in additional funding to the Australian Securities and Investments Commission (ASIC) and APRA
- providing improved redress
  - — the remit of the Australian Financial Complaints Authority (AFCA) has been extended to consider financial complaints going back to 2008
  - — there is an appropriation by the government of $30.7 million to fund unpaid legacy determinations (taxpayer funded)

Independent inquiry

An independent inquiry will be established in 3 years to ensure the financial sector has implemented the Royal Commission's recommendations and industry practices have changed and led to better consumer and small business outcomes.

Strong and effective financial regulators

As can be seen, the government has committed to additional funding for ASIC and APRA:

- more than $550 million in additional funding has been allocated to ASIC and APRA
- in this regard:
  - — the government will provide more than $400 million to ASIC including:
    - $146 million to undertake an accelerated enforcement approach to support the new "why not litigate?" strategy
    - $63.3 million for enhanced onsite supervision of large financial institutions
    - $69.9 million to ASIC to deliver on its expanded mandate as primary superannuation conduct regulator, including a focus on underperforming funds and compliance with the "best interests" duty
  - — APRA's budget will be increased by $152 million with a view to strengthening its supervisory and enforcement activities — $117 million of this funding will support APRA's response to key areas of concern raised by the Royal Commission, including with respect to gover-nance, culture and remuneration

Financial Regulatory Oversight Authority

$7.7 million of funding is being provided to establish an independent Financial Regulatory Oversight Authority to report on ASIC's and APRA's effectiveness.

Banking Executive Accountability Regime (BEAR)

APRA's increased budget includes $34.3 million to extend BEAR to all APRA-regulated entities, including superannuation funds and insurance companies.

ASIC's additional funding also includes $26.1 million to introduce a new conduct-focused accountability regime.[10]

AFCA and compensation

Historical complaints

The government will provide $2.8 million for AFCA to establish a historical redress scheme for eligible financial complaints dating back to 1 January 2008 (the timeline of events covered by the Royal Commission).

Legacy unpaid determinations

Government funding of $30.7 million will be made available to pay compensation owed to consumers and small businesses from legacy unpaid external dispute resolution determinations.

Compensation Scheme of Last Resort (CSLR)

The government has agreed to the establishment of a CSLR. The Treasury will be provided with $2.1 million and AFCA will be provided with $0.5 million to establish the scheme. The precise parameters and funding of this scheme remain unknown at this stage (although the source of funding for the forward-looking CSLR is likely to be industry).

Office of Parliamentary Counsel (OPC)

$900,000 in funding has been set aside for the OPC to enable it to deal with the volume of legislative drafting that will be required to implement the government's responses to the Royal Commission.

Financial Services Reform Implementation Taskforce

This taskforce will be established within the Treasury and will be allocated $11.2 million in 2019–20. Its purpose is to implement the government's responses and coordinate reform efforts with APRA, ASIC and other agencies through an implementation steering committee.

Advice, insurance and general matters

Advice

Recommendation	Government response	Observations
Recommendation 2.1 — Annual renewal and payment The Commission recommended that the law be amended to provide that ongoing fee arrangements (OFAs) (whenever made): • must be renewed annually by the client • must record in writing each year the services that the client will be entitled to receive and the total of the fees that are to be charged • may neither permit nor require payment of fees from any account held for or on behalf of the client, except on the client's express written authority to the entity that conducts that account given at, or immediately after, the latest renewal of the ongoing fee arrangement	The government agreed to this recommendation with the requirements to apply for all clients. This is to be compared with the current Future of Financial Advice (FoFA)-based requirements that client agreement is required only for OFAs for new clients after 1 July 2013. • the Commission highlighted "fee for no service" issues • this was "mostly associated" with clients in OFAs • the changes will "help ensure clients actively consider whether they are deriving benefits" from OFAs	Currently, OFAs generally contemplate the provision of advice over a period greater than 12 months. The practical implication of this may well be that OFAs going forward will be for 12 months or lesser periods. However, it may be more likely that OFAs will simply be for a 12-month period consistent with the recommendation.
Recommendation 2.2 — Disclosure of lack of independence There is currently no requirement as such for a financial adviser to explain to a retail client that the adviser is not independent. The Commissioner has recommended that the adviser explain in writing why the adviser is not independent, impartial or unbiased before providing personal advice to a retail client.	The government agreed to this recommendation.	The form of disclosure will be prescribed. This is perhaps the high-water mark of the calling out of any relevant conflicts. The practicality of any disclosure and whether clients will continue to seek advice from the disclosing adviser in those circumstances remains to be seen.
Recommendation 2.3 — Review of measures to improve the quality of advice In order to determine the effectiveness of the measures to improve the quality of advice, the Commissioner has recommended the government, in consultation with ASIC, undertake a review in 3 years (no later than 31 December 2022).	The government agreed to a review in 3 years' time on the effectiveness of measures to improve the quality of advice. The government referred in this regard to: • its reforms to increase educational, training and ethical standards of financial advisers • its design and distribution obligations and product intervention powers legislation	The Commissioner indicated that safe harbour provisions and APLs did not lead to an independent assessment of products.[11] This analysis however does not seem to consider that approved product lists (APL) formulation generally is fashioned and informed by extensive research. There are more than reasonable argu-ments that the necessary investigation of a client's

It is of interest here that the Commissioner recommended that: 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. Unless there is a clear justification for retaining that provision, it should be repealed.		particular circumstances may be met by an adviser making reference to an appropriate and con-sidered APL. Precisely what the antici-pated review will establish of course remains to be seen. However, perhaps we can anticipate that ASIC will focus on whether customers are "better off" — which seems to be an ASIC gloss on the statutory best interests duty.[12]
Recommendation 2.4 — Grandfathered commissions Grandfathering provisions for conflicted remuneration should be repealed as soon as is reasonably practicable.	The government agreed to end grandfathering of conflicted remuneration effective from 1 January 2021. The government envisages that the benefits of removal of grandfathering will flow to clients. From 1 January 2021, payments of any previously grandfathered conflicted remuneration will be required to be rebated to applicable clients if the applicable client can reasonably be identified. Where it is not practicable to rebate the benefit to an individual client because, for example, the grandfathered conflicted remuneration is volume-based so remuneration is unable to be attributed to any individual client, the government anticipates that industry will ensure these benefits pass through to clients indirectly (for example, by lowering product fees). ASIC has been directed by the government to monitor and report on the extent to which issuers are acting to end grandfathering arrangements for the period 1 July 2019 to 1 January 2021 and passing the benefits through to clients (whether by rebate or otherwise).[13]	On 22 February 2019, the government released the Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Bill 2019 (Cth) (Exposure Draft Bill) for consultation. The Exposure Draft Bill removes the grandfathering arrangements for conflicted remuneration and other banned remuneration from 1 January 2021. The Bill provides for regulations to be made to provide for the pass-through to customers of the benefits of any previously grandfathered conflicted remuneration remaining in contracts after 1 January 2021. Draft Regulations were issued by the Treasury for consultation on 28 March 2019. The Draft Regulations set out details on how benefits must be passed through to the customer and also impose record keeping obligations on persons required to pass-through benefits. It is worthwhile recalling here that in the Commonwealth jurisdiction, it is a fundamental principle that any acquisition of property must be on "just terms". This follows from the requirement in s 51(xxxi) of the Australian Constitution that the acquisition of property be "on just terms". This explains why rather curious savings provisions are found at appropriate points in the Corporations Act 2001 (Cth). For example, s 965 deals with anti-avoidance and subs (1) is the operative provision. However, subs (2) goes on to provide that:

		Subsection (1) does not apply to a scheme to the extent that the operation of the subsection would result in an acquisition of property (within the meaning of paragraph 51(xxxi) of the Constitution) from a person otherwise than on just terms (within the meaning of that paragraph of the Constitution). Submissions to the effect that there may be constitutional limitations on the ability of the parliament to legislate for the cessation of grandfathering were made to the Royal Commission. These received somewhat short shrift from the Commissioner: "where would be the 'acquisition'? Who would acquire anything? It is not apparent that any proprietary benefit or interest would accrue to any person."[14] Nevertheless, there have been some reports that a challenge or challenges to the proposed cessation of grandfathering on constitutional grounds is being considered.
Recommendation 2.5 — Life risk insurance commissions The Commissioner recommended that when ASIC conducts its review of conflicted remuneration relating to life risk insurance products and the operation of the ASIC Corporations (Life Insurance Commissions) Instrument 2017/510, ASIC should 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.	The government supports ASIC conducting the review in 2021 and considering the factors identified by the Royal Commission when undertaking this review. It has also reiterated the announcements made when the reforms were made, namely that the government said that it would move to mandate level commissions, as was recommended by the Financial System Inquiry if the review did not identify significant improvements in advice quality.	The Life Insurance Framework (LIF) reforms were introduced by the ASIC Instrument referred to in the first column. At the time, the LIF reforms were seen as a sensible compromise with the prospect of an ASIC review in 2021. It appears, however, that the continued operation of LIF after 2021 is somewhat in doubt.
Recommendation 2.6 — General insurance and consumer credit insurance commissions etc • the exemptions for general insurance products and consumer credit insurance products • the exemptions for non-monetary benefits set out in s 963C of the Corporations Act	The government agreed to review the remaining exemptions to the ban on conflicted remuneration in the course of its review in 3 years' time on the effectiveness of measures to improve the quality of advice.	The review will consider the retention or otherwise of so-called "soft dollar" benefits. These include small benefits, education and training, certain IT and importantly, non-monetary benefits to which a client has consented.

Recommendation 2.7 —Reference checking and information sharing All Australian Financial Services Licence (AFSL) holders should be required, as a condition of their licence, to give effect to reference checking and information sharing protocols for financial advisers, to the same effect as now provided by the Australian Banking Association (ABA) in its Financial Advice — Recruitment and Termination: Reference Checking and Information Sharing Protocol.[15]	The government agreed with this recommendation.	At a practical level, this will be a welcome change and will enable adviser reference checking on an industry-wide basis.
Recommendation 2.8 — Reporting compliance concerns All AFSL holders should be required, as a condition of their licence, to report "serious compliance concerns" about individual financial advisers to ASIC on a quarterly basis.	The government agreed to mandate the reporting of serious compliance concerns about individual financial advisers to ASIC on a quarterly basis. This is to be read in conjunction with the government's response to recommendation 7.2 to strengthen the current breach reporting obligations of an AFSL holder.	This approach highlights the increased compliance focus going forward on AFSL holders and the emphasis on individual responsibility for AFSL holders. This process of course already had started with ASIC requiring as part of its Wealth Management Project, relevant AFSL holders to report on any serious compliance concerns. This may well herald the start of a shift to a "whistleblowing" focus by AFSL holders in respect of compliance matters more generally. Certainly, other recommendations, such as breach reporting and addressing misconduct of advisers, suggest that there will be a greater emphasis on individual responsibility of licensees for a range of activities.
Recommendation 2.9 — Misconduct by financial advisers All AFSL holders should be required, as a condition of their licence, to take the following steps when they detect that a financial adviser has engaged in misconduct in respect of financial advice given to a retail client (whether by giving inappropriate advice or otherwise): • make whatever inquiries are reasonably necessary to determine the nature and full extent of the adviser's misconduct	The government agreed to require all AFSL holders to make whatever inquiries reasonably necessary to determine the nature and full extent of an adviser's misconduct (when the licensee detects misconduct) and inform and remediate affected clients promptly.	The government response indicates that the recommendation is to be reinforced by the government announcement to provide ASIC with a new directions power as part of its response to the ASIC Enforcement Review.[16] Again, this approach is indicative of the brave new world where intense and proactive action is required by a licensee in instances where it appears there has been misconduct by an adviser. One wonders whether licensees will be obliged to communicate with clients when licensees may not have

• where there is sufficient information to suggest that an adviser has engaged in misconduct, tell affected clients and remediate those clients promptly		complete visibility in respect of all of the potential loss or indeed any breach in respect of the client. This may have the potential to cause confusion and concern within the client base and if so, is hardly a "good customer experience" or outcome.
Recommendation 2.10 — A new disciplinary system The Commissioner recommended that 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	The government agreed to the introduction of a new disciplinary system for financial advisers.	The government response indicates that the new disciplinary body is one plank of its reform proposals in relation to the advice industry. The government sees this as a continuation of the ongoing professionalisation of the advice industry. This process commenced with the introduction of mandatory educational requirements, compliance with the Code of Ethics and the satisfaction of ongoing professional development requirements. The recommendation also demonstrates the sharpening of the focus on AFSL holders to assume greater responsibility for client outcomes, for example, if advisers are demonstrating acts or omissions which indicate serious compliance concerns, then there is a positive obligation on AFSL holders to make a report to this new central disciplinary body.

Insurance

Recommendation	Government response	Observations
Recommendation 4.1 — No hawking of insurance Recommendation 3.4 suggested that the hawking of superannuation products be prohibited.[17] This recommendation is in similar vein.	The government agreed to this recommendation, consistent with its response to recommendation 3.4. The government response noted that the recommendation did not propose restricting the ability of insurers contacting policyholders in relation to existing policies. The government also indicated that the definition of "hawking" will be clarified to include selling of a financial product during a meeting, call or	As mentioned in Part 1 of this article, careful drafting will be required to ensure that there are no unintended consequences of the new prohibition.[18] A number of these concerns have been addressed by the Financial Services Council (FSC) in its draft Life Insurance Code of Practice, version 2 (Code 2).[19]

	other contact initiated to discuss an unrelated financial product. This followed evidence led at the Royal Commission of vulnerable consumers sold insurance products through unsolicited telephone calls with pressure selling tactics being used. The outcome was that consumers purchased products they did not want or need.	
Recommendation 4.2 — Removing the exemptions for funeral expenses policies The law should be amended to: • remove the exclusion of funeral expenses policies from the definition of "financial product" • put beyond doubt that the consumer protection provisions of the ASIC Act apply to funeral expenses policies	The government agreed to this recommendation, ie, to ensure that it is clear that the consumer protection provisions of the ASIC Act apply to funeral expenses policies. The government response also refers to the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018 (Cth) (DDO and PIP Bill). The government also noted that the proposed product intervention powers would enable ASIC to intervene in the sale of funeral expenses policies where there is a risk of significant consumer harm. Further, the government indicated that it would restrict the ability of entities to use terms such as "insurer" and "insurance" to only those firms that have a legitimate interest in using terminology regarding insurance (for example APRA-regulated insurers, brokers and other distributors) to avoid any confusion for consumers as to the nature of the products they are purchasing.	Again, Code 2 contains a number of provisions which address some of these concerns. The exemption for funeral expenses policies appears to be a historical matter and this seems to be no valid reason why it should be excluded from the definition of "financial product". The DDO and PIP Bill now has passed the (prorogued) parliament and received Royal Assent on 5 April 2019. The Act is expressed in general principles and much of the substance will need to be developed through Regulatory Guides. It is to be hoped that once the Bill passes, ASIC will be willing to engage with industry to develop the parameters and scope of relevant Regulatory Guides.[20]
Recommendation 4.3 — Deferred sales model for add-on insurance A Treasury-led working group should develop an industry-wide deferred sales model for the sale of any add-on insurance products (except policies of comprehensive motor insurance). The model should be implemented as soon as is reasonably practicable. In order to determine the effectiveness of the measures to improve the quality of advice, the Commissioner recommended the government, in consultation with ASIC, undertake a review in 3 years (no later than 31 December 2022).	The government agreed to mandate deferred sales for add-on insurance products and tasked the Treasury to develop an appropriate deferred sales model. A deferred sales model would require consumers to separately engage with the insurance product that is being purchased rather than considering it at the same time as purchasing a typically much more expensive product. The government also referred in this regard to the DDO and PIP Bill.	It can be seen then that a number of the government reforms and the practical implementation and application of those reforms by ASIC depend upon engagement by industry with ASIC in developing practicable and useful DDO and PIP regulatory guidance which will give substance to that legislation.

Recommendation 4.4 — Cap on commissions ASIC should impose a cap on the amount of commission that may be paid to vehicle dealers in relation to the sale of add-on insurance products.	The government agreed to provide ASIC with the ability to cap commissions that may be paid to vehicle dealers in relation to the sale of add-on insurance products. The government noted that the value of the commissions paid in relation to add-on insurance products sold through vehicle dealers significantly exceeded the amounts paid out to consumers through claims. The government view thus is that high levels of commissions have contributed to poor consumer outcomes. From the government's perspective, ASIC's ability to cap commissions will ensure an appropriate cap is set and capable, and varied if required in response to any future concerns.	It will be interesting to see how this power is exercised and how the DDO and PIP legislation will interact with this power.
Recommendation 4.5 — Duty to take reasonable care not to make a misrepresentation to an insurer Part IV of the Insurance Contracts Act 1984 (Cth) (ICA) 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 Div 3).	The government agreed to amend the duty of disclosure for consumers in the ICA as recommended. The government indicated that the policy perspective was to ensure that obligations for disclosure applied to consumers do not enable insurers to unduly reject the payment of legitimate claims. The government did acknowledge the importance of the duty of disclosure, ie, ensure that insurers are able to appropriately price the risks being underwritten through limiting the risk of fraud and misleading disclosures. The government sees the current approach as defective however, and not in the interests of consumers: However, the: > … current requirements fall short of adequately safeguarding consumers against having their claims declined where they may have inadvertently failed to disclose their past circumstances or because insurers have failed to ask the right questions.[21]	In effect, this is the substitution of the duty of disclosure with a duty to take reasonable care to not make a misrepresentation (this is the United Kingdom position).[22] This recommendation should be read with recommendation 4.6 in relation to the avoidance of life insurance contracts and recommendation 4.7, the application of unfair contract term provisions to insurance contracts. Again, this is a consumer-centric approach. The analysis here appears to be that consumers do not necessarily know or understand what to disclose on the basis that it is material to the underwritten risk and the insurer has the responsibility of asking for the necessary information.
Recommendation 4.6 — Avoidance of life insurance contracts The Commissioner recommended that s 29(3) of the ICA should be amended so that an insurer may only avoid a contract of life insurance on the basis of non-disclosure or misrepresentation if it can show that it would not have entered into a contract on any terms.	The government agreed to amend the ICA to ensure that insurers only avoid a contract of life insurance on the basis of non-disclosure or misrepresentation if it can show that it would not have entered into a contract on any terms. The government's analysis here is that consistently with its response to	Currently, s 29(3) ICA provides that upon becoming aware of an insured's non-fraudulent misrepresentation or non-disclosure, a life insurer may, within 3 years after entering into the insurance contract, avoid the contract if they would not have offered the contract on the same terms had the misrepresentation or non-disclosure not occurred.

	recommendation 4.5, while appropriate disclosure is important to ensure that insurers are able to appropriately price the risks being underwritten, it is essential that appropriate safeguards are in place to avoid consumers having their claims declined where they may have failed to disclose a matter that would not have had any real bearing on the likelihood of them being offered insurance or the price of the insurance.	However, the current position differs from the pre-2014 formulation. This imposed a stricter precondition to life insurers seeking to avoid an insurance contract. The prior s 29(3) required the insurer to show not only that it would not have offered the same contract to the insured, but rather that it would not have entered into a contract for insurance "on any terms". The recommendation thus is a proposal that s 29(3) revert to its prior drafting. The Commissioner characterised the amended legislation as entitling insurers to an avoidance regime which was unfairly weighted against insurers. Although this recommendation appears to mark a reversion to pre-2014 law, in the post-Royal Commission world, activities of financial service providers will be subject to more intense scrutiny, particularly from regulators. For example, one of the general obligations of an AFSL holder is to: > … do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly[.][23] Breach of this provision will be a breach of a civil penalty provision with increased penalties applying in respect of every breach.[24] It must be asked what informs the provision of financial services, *honestly, fairly and efficiently*.[25] Certainly, it might be thought that "community expectations" might colour the meaning of these terms. Unfortunately, the expression is of such wide import that it is difficult to give any definitive response to any particular circumstance or event. Avoidance of an insurance contract, depending upon the particular circumstances, might fail the community expectations formulation. In any event, insurers in these circumstances face the possibility of being obliged to respond to an insurance contract even if misrepresentations have been made — provided, of course,

		that the misrepresentation was not of sufficient magnitude that the insurer would not have offered a policy at all.
Recommendation 4.7 — Application of unfair contract terms provisions to insurance contracts The Commissioner recommended that the ASIC Act unfair contract terms should apply to insurance contracts regulated by the ICA. 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 s 13 of the ICA should operate independently of the unfair contract terms provisions.	The government agreed with this recommendation.	Industry consultation on the policy issues (previously raised in the 2017 Senate Economics References Committee Inquiry into the General Insurance Industry and by the Treasury), took place between June and August 2018. It will be interesting to analyse the drafting of legislation designed to implement this recommendation. It also should be noted that certain insurance contracts are excluded from the ambit of the ICA (for example, treaties of reinsurance). It is important that final legislation reflects the specific nature of life insurance, for example, by allowing premiums to be adjusted as required throughout the extremely long duration of some policies.
Recommendation 4.8 — Removal of claims handling exemption The Commissioner recommended that the handling and settlement of insurance claims, or potential insurance claims, should no longer be excluded from the definition of "financial service".	The government agreed to remove the exemption for the handling and settlement of insurance claims from the definition of a financial service. The government referred to inappropriate claims handling practices highlighted in the insurance hearings of the Royal Commission.	It should be noted that in the view of the Commissioner, it should not be unreasonable to ask an insurer to handle claims efficiently, honestly and fairly. The Treasury has consulted on this recommendation. The policy underlying the recommendation is that ASIC will be able to apply, and ensure the consumer can expect, the same standard of behaviour from insurers handling claims as they can from all financial service providers. The origins of the exemption extend back to the original *Corporate Law Economic Reform Program Paper No 6*[26] (CLERP 6) legislation. There are issues of course with the proposal. One which has been highlighted and which the Treasury appreciates is that claims handling staff may be deemed as providing personal financial advice (and thus be subject to the licensing requirements of the Corporations Act).

		The Treasury has indicated that it is considering the matter from the perspective of implementing the recommendation and ensuring insurers are subject to appropriate obligations without increasing regulatory complexity
Recommendation 4.9 — Enforceable code provisions Consistently with recommendation 1.15, the Commissioner recommended that the law be amended to provide for enforceable provisions of industry codes and for the establishment and imposition of mandatory industry codes. In respect of the Life Insurance Code of Practice, the Insurance in Superannuation Voluntary Code and the General Insurance Code of Practice, the FSC, the Insurance Council of Australia and ASIC should take all necessary steps by 30 June 2021 to have the provisions of those codes that govern the terms of the contract made or to be made between the insurer and the policyholder designated as "enforceable code provisions".	The government has indicated that it supports the FSC, the Insurance Council of Australia and ASIC acting on this recommendation, following the implementation of the government response to recommendation 1.15 about ASIC's powers to approve codes with enforceable provisions. The government also noted that this addresses the Productivity Commission's report *Superannuation: Assessing Efficiency and Competitiveness*.[27] That report recommended a binding and enforceable superannuation insurance code of conduct, which would thereafter become a condition of holding a registrable superannuation entity (RSE) licence.	At the time of writing, the Treasury is consulting on the recommendation — *Enforceability of Financial Services Industry Codes*. It is clear that the Commissioner thought industry codes should have more "teeth". Both the Commissioner and counsel assisting made reference to the enforcement powers of the ACCC under Pt IVB of the Competition and Consumer Act 2010 (Cth) (CCA). The question thus becomes whether this model should be applied in relation to financial services industry codes. It is important to note that the Commissioner did not advance the proposition that every provision in an industry code is to be an enforceable promise. Rather, where a provision is identified by the code as an enforceable code provision, then those provisions should be enforceable, and a breach of that provision should have consequences to the extent set out in legislation. The purpose of designating certain provisions as enforceable code provisions is intended to bring clarity to which of these provisions form part of a contractual or quasi-contractual relationship between, say, an insurer and an insured. Importantly, the Commissioner remarked that a breach of an enforceable code provision should constitute a "breach of the law". Under the CCA, certain provisions in the relevant codes are treated as enforceable, given that a breach of these provisions constitutes a breach of a civil penalty provision. In addition,

		the ACCC may pursue other regulatory action which would not be available to a consumer. Clearly this model is most consistent with the Commissioner's views and one which appears to have a degree of support from the Treasury. This is a significant change from the current position, where for example, the Life Insurance Code of Practice is expressed not to create legal relations between the insured and the insurer. An analogy here perhaps may be the current ability of ASIC to effectively amend legislation through the use of Class Orders.
Recommendation 4.10 — Extension of the sanctions power The Commissioner recommended that the FSC and the Insurance Council of Australia amend s 13.10 of the Life Insurance Code of Practice and s 13.11 of the General Insurance Code of Practice, respectively, to empower (as the case requires) the Life Code Compliance Committee or the Code Governance Committee to impose sanctions on a subscriber that has breached the applicable Code.	The government supports the FSC in the Insurance Council of Australia acting on the recommendation.	For its part, the FSC will consider this recommendation in the course of the revision of Code 2.
Recommendation 4.11 — Cooperation with AFCA The Commissioner recommended that s 912A of the Corporations Act be amended to require that AFSL holders take reasonable steps to cooperate with AFCA in its resolution of particular disputes, including, in particular, by making available to AFCA all relevant documents and records relating to issues in dispute.	The government agreed with this recommendation.	Prudently, AFCA members should and reconsider their processes for dealing with AFCA going forward. Breaches of provisions may give rise to uninvited regulatory scrutiny and significant penalties. This is the case particularly when the primary regulator, ASIC, is starting from a fundamental position in matters of breach "why not litigate?".
Recommendation 4.12 — Accountability regime The Commissioner recommended that in the course of time, provisions modelled on the BEAR should be extended to all APRA-regulated insurers, as referred to in recommendation 6.8.	The government agreed with this recommendation. This is consistent with the government's response to recommendation 6.8 concerning the extension of the BEAR regime to all APRA regulated entities.	As mentioned in Part 1 of this article, in the discussion of recommendations 3.9 and 6.8, we are moving from BEAR to FEAR — Finance Executive Accountability Regime. As indicated in Part 1, the extension of the BEAR represents a new paradigm for the financial services industry.

		Care will need to be taken in drafting of the legislation to ensure that there are no unintended consequences and that the legislation accommodates the diversity of activity within the sector (just as the current BEAR accommodates differences in size in authorised deposit-taking institutions (ADIs)). There also is a real and significant question as to whether the regulators are appropriately resourced in administering and enforcing the new provisions.
Recommendation 4.13 — Universal terms review The Commissioner recommended that the Treasury, in consultation with industry, should determine the practicability and likely pricing effects of legislating universal key definitions, terms and exclusions for default MySuper group life policies.	The government agreed with this recommendation.	The Treasury has issued a Consultation Paper on this topic. The paper outlines other issues raised by the Commissioner in his report, including the merits of prescribing following: • higher minimum coverage for life insurance than is currently provided for by the Superannuation Guarantee (Administration) Regulations 2018 (Cth) • minimum coverage for permanent incapacity insurance • maximum coverage for life and/or permanent incapacity insurance • a fixed level of coverage for life and/or permanent incapacity insurance so as to set a standard amount of default insurance across all MySuper products
Recommendation 4.14 — Additional scrutiny for related party engagements The Commissioner recommended that APRA amend Prudential Standard SPS 250 to require RSE licensees that engage a related party to provide group life insurance, or to enter into a contract, arrangement or understanding with a life insurer by which the insurer is given a priority or privilege in connection with the provision of life insurance, to obtain and provide to APRA within a fixed time, independent certification that the arrangements and policies entered into are in the best interests of members and otherwise satisfy legal and regulatory requirements.	The government agreed with this recommendation.	Related party transactions by their very nature carry a degree of risk. That risk however, can be managed and addressed by entering into the transaction on an arm's-length basis.[28] However, the Commissioner clearly thought that this was not the end of the matter. In the context of RSE licensees, the Commissioner made the following observations: • Disclosure of conflicts of interest on its own is not enough, for example, dealing with related parties. The statutory duty to comply with RSE licensee law and to perform properly the duties of the trustee demands action, not just disclosure.[29]

The Commissioner recommended that in the course of time, provisions modelled on the BEAR should be extended to all APRA-regulated insurers, as referred to in recommendation 6.8.		• The best interests covenant makes it clear that the trustee's obligation is to perform its duties and exercise its powers in the best interests of members. The Commissioner discussed outsourcing of administration and management of the fund to a related entity and indeed any third party, ongoing care and diligence is required by the trustee. The Commissioner stated: Where it is relying on information provided by the related entity, it must test the information it receives and seek further information where necessary. The trustee must satisfy itself that the trust is being run in the best interests of the members. The case studies showed that trustees are not always discharging this responsibility and regulators have not acted on this.[30] • Regulators need to be astute to ensure trustees give priority to the interests of members: As already noted, proper performance of the best interests duty is essential to trustees meeting the financial promises they make. Performance of that duty is central to achieving the best outcomes for members. It should be remembered that Prudential Standard SPS 231 provides that an RSE licensee who outsources a material business activity to a related party "must be able to demonstrate that the arrangement is conducted on an arm's length basis and in the best interests of beneficiaries". The case studies suggest that, to date, this obligation has not led to sufficient rigour in the selection and monitoring of related-party service providers. As later explained in the chapter on insurance, I recommend additional scrutiny for related-party engagements.[31] • APRA has indicated that it will give effect to this recommendation:[32] — a review of the recommendation will be undertaken as part of its review of the superannuation — in the second quarter of 2019 it is intended to publish the review report, with consultation on revised standards commencing after that point

		— it is anticipated that a new standard will be finalised in 2020 Thus, going forward we can anticipate that this will be a regulatory focus — not only from the perspective of compliance with the revised standard but also from the viewpoint of satisfaction of the best interests duty.
Recommendation 4.15 — Status attribution to be fair and reasonable APRA should amend Prudential Standard SPS 250 to require RSE licensees to be satisfied that the rules by which a particular status is attributed to a member in connection with insurance are fair and reasonable.	The government agreed with this recommendation and supported APRA in making this change.	This relates to members who, for example leave employment of the employer, switch to a personal category with higher premium rates. The comments made concerning the APRA response in relation to recommendation 4.14, also apply here. This issue is addressed in Code 2.

Culture, governance and remuneration

The Commissioner made seven recommendations in this context. The underlying message flowing through the various recommendations is that APRA in its supervision of remuneration systems and revising prudential standards and guidance concerning remuneration should consider and have one of its aims, not only financial risk but also misconduct, compliance and other non-financial risks.[33]

APRA has indicated that it will release proposed revisions to Prudential Standard CPS 510 by mid-2019 addressing these recommendations. In addition, APRA will consider outcomes from its recent activity, the Commonwealth Bank of Australia (CBA) Prudential Inquiry, self-assessments by other entities and relevant international guidance. The intention is to have a final standard in place in 2020.

APRA also should have a strong and proactive role in supervising both culture and governance.[34] Amongst other things, this prudential supervision and revision of prudential standards and guidance 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
- encourage entities to give proper attention to sound management of conduct risk and improving entity governance

APRA has indicated that this process is underway, and it is reviewing its approach to the supervision of governance culture and remuneration; and having regard to the activities and factors mentioned above, APRA has said that this is a "multi-year program".[35]

A major issue here for the regulator is capacity and resources — APRA has stated that it is working with the government to ensure it has sufficient resources to implement the recommendation.

Thus, it can be seen that going forward the prudential regulator will, as part of its remit, regulate non-financial risk matters such as remuneration culture and governance. The clear direction for APRA-regulated institutions is to review these particular risk matters as often as reasonably necessary or required. The process which began with the CBA Prudential Inquiry continues at a more holistic level and across all APRA-regulated institutions. This will necessitate a review by these institutions of its current processes and risk metrics.

The regulators

We can anticipate increased cooperation between ASIC and APRA — the Commissioner recommended that ASIC and APRA prepare and maintain a joint memorandum setting out how they intend to comply with their statutory obligation to cooperate. The memorandum is to be reviewed biennially and each regulator is to report each year of operation and steps taken under it in its annual report.[36]

The regulators are reviewing the current Memorandum of Understanding between them. It is anticipated the work will be completed by the end of 2019.

The Commissioner also recommended that the BEAR be applied to the regulators.[37] The government has endorsed this approach and referred to the position in the United Kingdom where the Financial Conduct Authority has adopted a similar regime to enhance its own internal accountability. The regulators intend to develop and publish accountabilities statements before the end of 2019.

Following the Royal Commission and the introduction of the oversight body, we will see greater scrutiny and focus upon the activities and effectiveness of the regulators particularly where they have similar or overarching responsibilities.[38]

The existing process of annual reports and parliamentary oversight clearly has not been sufficient or effective. Thus, the "twin peaks" of financial services regulation continues but these peaks will be extensively remodelled. This comment from ASIC is telling in this regard:

> ASIC's changed enforcement approach is part of a broader change program initiated in 2018. This includes additional Commission members and a new leadership structure, a new Vision and Mission, and changes to ASIC's governance, structure and decision-making. In addition to adopting a strategy of greater court-based enforcement, it includes the adoption of new regulatory and supervisory approaches, such as Close and Continuous Monitoring (CCM) and the adoption of next generation regulatory tools, including through leading developments in behavioural economics, data analytics and RegTech.[39]

Reference previously has been made to ASIC's revised enforcement culture which requires investigations to be conducted with a clear view on the focus of regulatory outcomes to be achieved and with a focus on the question "why not litigate?". ASIC also is establishing an Office of Enforcement within itself.[40]

We can only wait to see what the outcome of this new approach might be in a practical sense. It is to be hoped that the utilitarian value of either litigating or not litigating will be considered by the Office of Enforcement and ASIC more generally going forward.

Looking forward

What can we expect to see in the future as a result of the report?

My very brief comments are as follows:

- More legislation and regulation — although the Commissioner correctly, in my respectful opinion, said that we did not need more legislation but more effective enforcement of what we have at the moment, it is inevitable that more legislation will be introduced. This will be necessary if only to give effect to specific recommendations such as the end of grandfathering and extension of the BEAR to all APRA-regulated institutions. In this latter respect, we also should keep in mind that the government has taken the recommendations a step further with its proposal for the introduction of a new regime, regulated by ASIC and extending its coverage to non-prudentially regulated entities.
- Necessarily, this will involve extensive consultation between the Treasury and all relevant stakeholders. It will be some time before the final scheme of regulation post-Royal Commission is settled.
- Clearly, we will face more active regulators with a sharper focus on enforcement and with appropriate resources to pursue the regulatory agenda. As can be seen by the Budget comments, the regulators have the support of government in the new focus and approach.[41] An example of this is the government's intention to expand the jurisdiction of the Federal Court to cover corporate criminal misconduct to expedite the consideration of cases brought by the regulators.
- More generally, we can expect to see a change in the way in which the regulators interact with industry. We now have the ASIC Office of Enforcement and the observations by the Commissioner that ASIC should not agree to an enforceable undertaking from an industry participant in respect of civil penalty provisions without an acknowledgment of breach of the law.[42] Commonly, in such arrangements in the past, so as to not raise further liability issues, industry participants would not acknowledge breach but accept that the ASIC view was reasonable. Industry participants may well be unwilling to enter into an enforceable undertaking on the basis that there is an acknowledgment of breach by the participant.
- All sectors of the industry will need to review and revise risk and governance arrangements, not only to ensure compliance with the black letter law, but also matters which once might have been considered to be more ephemeral, such as culture and remuneration of participants.
- We may well see the Royal Commission concept of "community expectations" colour the meaning to be given to the obligation for an AFSL holder to provide the relevant financial service "efficiently, honestly and fairly" as provided by s 912A(1)(a) of the Corporations Act. This is particularly important given the significant range and scope of penalties (and other potential consequences) which will apply to a breach of that obligation going forward.

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The views expressed in this article are those of the author only. They do not represent the views or opinions of the Financial Services Council or any of its members.

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Footnotes

1. Royal Commission *Interim Report* (28 September 2018) https://financialservices.royalcommission.gov.au/Pages/reports.aspx.
2. Royal Commission *Final Report* (4 February 2019) https://financialservices.royalcommission.gov.au/Pages/reports.aspx.
3. Although of course some of the insurance-related recommendations impact on general insurance also — for example deferred sales models for add-on insurance (some elements of this may be life insurance and some may be general insurance).
4. For one analysis of the possible themes which are discernible in the Report, and their implications, I refer readers to M Vrisakis and S Rice "The Financial Services Royal Commission: emerging themes and lessons for all" 2019) 18(2&3) *FSN* 36.
5. This paper, in accordance with convention, addresses the government response only as indicated, although the opposition has largely accepted the recommendations and in some respects opposition policy "goes further" than that of the government.
6. The Treasury, Consultations, https://treasury.gov.au/consultation:
    - Universal terms for insurance within MySuper
    - Ending Grandfathered Conflicted Remuneration for Financial Advisers: Draft regulations
    - Enforceability of financial services industry codes
    - Insurance Claims Handling
7. The Treasury *Guaranteeing Essentials Services: The Benefits of a Strong Economy* (2019) www.budget.gov.au/2019-20/content/download/essentials.pdf.
8. Above, at 16.
9. It appears this review will cost $1 million and has been included in the current budget cycle.
10. Compare with government response to recommendation 6.8 — refer to discussion in Part 1: P Callaghan "The Financial Services Royal Commission: quo vadis, Financial Services Industry? Part 1 — superannuation (and vertical integration)" (2019) 18(2&3) *FSN* 28: The government agrees to extend the BEAR to all APRA regulated entities, including insurers and superannuation RSEs. Further, the government will introduce a similar regime for non-prudentially regulated financial firms focused on conduct.
11. Above n 2, Vol 1 at 168 and 177.
12. ASIC *Financial Advice: Vertically Integrated Institutions and Conflicts of Interest* Report No 562 (January 2018) https://download.asic.gov.au/media/4807789/rep-562-published-04-july-2018.pdf para 23: "However, these files did not demonstrate that the customer would be in a better position following the advice."
13. The government issued a Ministerial Direction under s 14 of the Australian Securities and Investments Commission Act 2001 (Cth), accordingly requiring that ASIC undertake an investigation to monitor and report on industry behaviour in the period 1 July 2019 to 1 January 2021.
14. Above n 1, Vol 1 at 95, referring to *JT International SA v Commonwealth; British American Tobacco Australasia Ltd v Commonwealth* (2012) 250 CLR 1; 291 ALR 669; [2012] HCA 43; BC201207608. The Commissioner also made the following somewhat pragmatic observation:

    > But second, and no less importantly, if the point is good, it was good when most forms of conflicted remuneration were prohibited. Yet no-one sought then to challenge the validity of the relevant provisions and the FoFA bans on conflicted remuneration have now been operating for five years without challenge.

15. ABA, Financial Advice — Recruitment and Termination: Reference Checking and Information Sharing Protocol, 20 September 2016, www.ausbanking.org.au/wp-content/uploads/2019/05/ABA-Reference-Checking-and-Information-Sharing-Protocol-FINAL.pdf.
16. ASIC Enforcement Review Taskforce *Positions Paper 7: Strengthening Penalties for Corporate and Financial Sector Misconduct* (2017) https://treasury.gov.au/sites/default/files/2019-03/c2017-t232150.pdf.
17. P Callaghan, above n 9, at 31.
18. P Callaghan, above n 9, at 31–2.
19. FSC, Life Insurance Draft Code of Practice 2.0, 12 November 2018, www.fsc.org.au/policy/life-insurance/code-of-practice/code-2-0.
20. Noting that the PIP provisions commence on the day after Royal Assent and the DDO provisions commence 2 years after the date of Royal Assent.
22. Compare with Consumer Insurance (Disclosure and Representations) Act 2012 (UK).
21. The Treasury *Restoring Trust in Australia's Financial System* (February 2019) https://treasury.gov.au/sites/default/files/2019-03/FSRC-Government-Response-1.pdf at 24.
23. Corporations Act, s 912A(1)(a).
24. Compare with Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019 (Cth).
25. See discussion by Beach J in *ASIC v Westpac Banking Corp (No 2)* (2018) 357 ALR 240; 127 ACSR 110; [2018] FCA 751; BC201804154 and the cases cited there.
26. The Treasury *Financial Markets and Investment Products: Promoting Competition, Financial Innovation and Investment — Corporate Law Economic Reform Program Paper No 6* (1997) http://archive.treasury.gov.au/documents/286/PDF/full.pdf.
27. Productivity Commission *Superannuation: Assessing Efficiency and Competitiveness* Inquiry Report No 91 (21 December 2018) www.pc.gov.au/inquiries/completed/superannuation/assessment/report/superannuation-assessment.pdf.

28. Compare with Superannuation Industry (Supervision) Act 1993 (Cth) (SIS), s 109 — Investments of superannuation entity to be made and maintained on arm's length basis.
29. SIS, s 29E(1)(a) and (b): referred to in above n 2, Vol 1 at 231.
30. Above n 2, at 231–2.
31. Above n 2, at 232.
32. APRA, APRA's responses to Royal Commission recommendations, www.apra.gov.au/sites/default/files/table_with_apras_responses_to_royal_commission_recommendations-v1.pdf at 2.
33. See for example above n 2, Vol 1 recommendations 5.1, 5.2 and 5.3.
34. See for example above n 2, Vol 1, recommendation 5.7.
35. Above n 2, Vol 1 at 231.
36. Above n 2, Vol 1 recommendation 6.10.
37. Above n 2, Vol 1 recommendation 6.12. A similar proposal was put forward in Financial System Inquiry *Final Report* (November 2014) http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf recommendation 27.
38. Here we have a prime example of the ancient formulation by Juvenal in Satires (Satire VI, lines 347–8): "quis custodiet ipsos custodes?", which means "who watches the watchers?".
39. ASIC *ASIC Update on Implementation of Royal Commission Recommendations* (February 2019) https://download.asic.gov.au/media/5011933/asic-update-on-implementation-of-royal-commission-recommendations.pdf at 4. See also above n 2, Vol 1 at 427.
40. This is discussed in some detail in above, Appendix.
41. And for that matter, the opposition.
42. Above n 2, Vol 1 at 443.